

THE FOOTNOTES RECORD

Item No.	Item	Character position	Date type	Comments
1	Schedule ID	1	Character	Enter 'F'.
2	Sequence Number	2-7	Numeric	Right justified, zero filled, see general instruction 3.
3	Company ID	8-13	Numeric	Reporting pipeline code, from buyer/seller code list, see general instruction 6(A).
4	Reference Number	14-23	Numeric	Reference number for record being footnoted. See general instruction 4.
5	Footnote Text	24-155	Character	

Standards of Conduct and Reporting Requirements for Transportation and Affiliate Transactions—Docket No. RM94-6-000

(Issued June 17, 1994)

Hoecker, Commissioner, concurring in part and dissenting in part:

Today I concur that the time has come to cut the regulatory burden associated with the marketing affiliate rules, particularly the filing and record maintenance requirements tentatively adopted six years ago to ensure an equitable transition to competition among independent and pipeline-affiliated marketers. My colleagues and I disagree only in part and that disagreement is surely a matter of degree, not principle.

I support the retention of the modestly revised Standards of Conduct applicable to pipeline relationships with marketing affiliates because, under these circumstances, they impose a useful and relatively light-handed transactional discipline on these relationships and help guarantee fair play and equal information in the marketplace.

I nevertheless think the retention of the reporting and records maintenance requirements in revised FERC Form No. 592 is excessive and unnecessary.¹ I am inclined to think it demonstrates an unhappy tendency to which we all occasionally fall prey in a bureaucratic culture: assumptions and requirements, once adopted, tend to perpetuate themselves beyond their useful lives. As Vice President Gore's National Performance Review observes:

The federal government does at least one thing well: It generates red tape. But not one inch of that red tape appears by accident. In fact, the government creates it all with the best of intentions. It is time now to put aside our reverence for those good intentions and examine what they have created—a system that makes it hard for our civil servants to do what we pay them for, and frustrates taxpayers who rightfully expect their money's worth.²

This might strike my readers as rhetorical overkill as applied to this case, given the best of intentions that underlies today's decision

to retain the reporting requirements and FERC Form No. 592. After all, the rule claims (somewhat inexplicably) that on average they will require only 60 workhours from each company per year. Yet, the continuation of these recordkeeping requirements is not, in my estimation, supported by any strong evidence of need. I find no significant numbers or patterns of complaints alleging that pipelines have favored affiliates. There is virtually no evidence of industry interest in these data. In fact, in one of the few pleadings in this case that offers more than opinion, a major pipeline system indicates that its Order No. 497 log was accessed only an average of 2-3 times monthly since 1990, with a significant portion of those calls (up to 50 percent at times) coming from Commission staff. The rule was not designed to generate discounting data for rate cases. Nor was it formulated as a device to obviate discovery in rare complaint cases. The need for these data is, therefore, highly conjectural.

In the final analysis, it is clear that the majority wants to retain this small part of the Code of Federal Regulations "just in case." And, by eliminating the sunset date, it is likely that FERC Form No. 592 will linger in regulatory perpetuity. In my opinion, the cost (however small) to the industry and ultimately to ratepayers of continuing any part of this recordkeeping requirement is greater than any probable benefit.

Therefore, I dissent from that aspect of the rule that continues FERC Form No. 592.

James J. Hoecker,
Commissioner.

[FR Doc. 94-15372 Filed 6-24-94; 8:45 am]

BILLING CODE 8717-01-P

DEPARTMENT OF THE TREASURY

Customs Service

19 CFR Part 12

[T.D. 94-54]

RIN 1515-AB55

Extension of Import Restrictions on Significant Archaeological Artifacts from Peru

AGENCY: Customs Service, Treasury.

ACTION: Final rule.

SUMMARY: This document amends the Customs Regulations to reflect the

extension of the import restrictions on culturally significant archaeological artifacts from the Sipan Region of Peru which were imposed by T.D. 90-37. The Deputy Director of the United States Information Agency (USIA) has determined that the emergency conditions which originally warranted the imposition of import restrictions still exist. Accordingly, the restrictions will continue to be in effect for an additional three years, and the Customs Regulations are being amended to indicate this extension.

EFFECTIVE DATE: June 27, 1994.

FOR FURTHER INFORMATION CONTACT:
Legal Aspects: John Atwood, Chief,
Intellectual Property Rights Branch,
(202) 482-6960.

Operational Aspects: Roland Bernier,
Chief, Other Agency Enforcement
Branch, Office of Trade Operations,
(202) 927-0051.

SUPPLEMENTARY INFORMATION:

Background

Pursuant to the provisions of the Convention on Cultural Property Implementation Act, the Deputy Director of the United States Information Agency (USIA), after consultation with the Secretaries of State and Treasury, determined that certain archaeological materials from the Sipan Archaeological Region of Peru, which material was identified as comprising part of Peru's cultural patrimony forming part of the remains of the Moche culture were being pillaged, or in danger of being pillaged, in crisis proportions and that an emergency condition existed which warranted the imposition of a prohibition on the importation of such articles into the United States. In T.D. 90-37, the Customs Service announced the imposition of import restrictions and identified the types of articles covered by the restrictions.

The Deputy Director of the USIA has considered the recommendations of the Cultural Property Advisory Committee and determined that the emergency conditions which warranted imposition of the initial restrictions still exist and

¹ FERC Form No. 592 is codified in section 250.16 of the Commission's regulations. If this form were eliminated, I believe certain of the other requirements contained in section 250.16 (such as the requirement to include specified information in the tariff) could be transferred to the Standards of Conduct to allow for complete recision of section 250.16.

² *Creating a Government that Works Better & Costs Less*, Report of the National Performance Review, 1993, p. 11.

has decided to extend the import restrictions for another three years. (See 59 FR 30633, June 14, 1994.)

Accordingly, Customs is amending § 12.104g (19 CFR 12.104g) to reflect the extension of the import restriction.

Executive Order 12866 and Regulatory Flexibility Act

This amendment is not a "significant regulatory action" within the meaning of E.O. 12866. Because no notice of proposed rulemaking is required, the provisions of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) do not apply.

Inapplicability of Notice and Delayed Effective Date

Because this amendment reflects the extension of emergency import restrictions on cultural property which is currently subject to pillage and looting, pursuant to section 553(b)(B) of the Administrative Procedure Act, no notice of proposed rulemaking or public procedure is necessary. For the same reason, a delayed effective date is both impracticable and contrary to the public interest.

Drafting Information

The principal author of this amendment was Peter T. Lynch, Regulations Branch, Office of Regulations and Rulings, U.S. Customs Service. However, personnel from other offices participated in its development.

List of Subjects in 19 CFR Part 12

Customs duties and inspections, Imports, Cultural property.

Amendment to the Regulations

Accordingly, Part 12 of the Customs Regulations (19 CFR part 12) is amended as set forth below:

Part 12—Special Classes of Merchandise

1. The general and specific authority citation for Part 12 continues to read as follows:

Authority: 5 U.S.C. 301, 19 U.S.C. 66, 1202 (General note 17, Harmonized Tariff Schedule of the United States (HTSUS)), 1624;

* * *

Sections 12.104—12.104i also issued under 19 U.S.C. 2612.

* * *

2. Section 12.104g is amended by adding "extended by 94-54" immediately after the entry "90-37" in

the column headed "T.D. No." adjacent to the entry for Peru.

Michael H. Lane,

Acting Commissioner of Customs.

Approved: June 15, 1994.

John P. Simpson,

Deputy Assistant Secretary of the Treasury.

[FR Doc. 94-15528 Filed 6-24-94; 8:45 am]

BILLING CODE 4820-02-P

Internal Revenue Service

26 CFR Part 1

[TD 8547]

RIN 1545-AR54

Limitation on Annual Compensation for Qualified Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the compensation limit for tax-qualified retirement plans under section 401(a)(17) of the Internal Revenue Code of 1986. These regulations reflect changes made by the Tax Reform Act of 1986, the Technical and Miscellaneous Revenue Act of 1988, and the Omnibus Budget Reconciliation Act of 1993. These regulations provide guidance necessary to comply with the law and affect sponsors of, and participants in, tax-qualified retirement plans.

DATES: These regulations are effective January 1, 1994, and apply to plan years beginning on or after January 1, 1994, except as otherwise provided in § 1.401(a)(17)-1(d).

FOR FURTHER INFORMATION CONTACT: Marjorie Hoffman at (202) 622-4606 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On September 19, 1991, final regulations under section 401(a)(17) (TD 8362) were published in the *Federal Register* (56 FR 47603). On August 10, 1992, the IRS published in the *Federal Register* (57 FR 35536) regulations proposing to extend the effective date of the final regulations under section 401(a)(17) (and related regulations), generally to plan years beginning on or after January 1, 1994.

On December 30, 1993, proposed regulations under section 401(a)(17) amending the final regulations were published in the *Federal Register* (58 FR 69302). Written comments were received from the public on the proposed regulations. Because the only

request for a public hearing was withdrawn, no public hearing was held. After considering all of the written comments received, the proposed regulations are adopted as modified by this Treasury decision.

Statutory Authority

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under section 401(a)(17) of the Internal Revenue Code (Code). These regulations reflect the enactment of section 401(a)(17) by section 1106 of the Tax Reform Act of 1986 (TRA '86), and subsequent statutory changes made by section 1011(d)(4) of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) and section 13212 of the Omnibus Budget Reconciliation Act of 1993 (OBRA '93). These regulations are issued under the authority contained in section 7805 of the Code.

Explanation of Provisions

1. Overview

Section 401(a)(17) of the Code provides an annual compensation limit for each employee under a qualified plan. This limit applies to a plan in two ways. First, a plan may not base contributions or benefits on compensation in excess of the annual limit. Thus, a plan does not satisfy section 401(a)(17) unless it provides that an employee's compensation in excess of the annual limit is not used in determining allocations or accruals for a plan year to which the annual limit applies. Second, the amount of an employee's annual compensation that may be taken into account in applying certain specified nondiscrimination rules under the Code is subject to the annual compensation limit. Thus, for example, an employee's compensation in excess of the annual limit is disregarded in determining the accrual rates for defined benefit plans under those nondiscrimination rules. The annual compensation limit applies separately to each group of plans that is treated as a single plan for purposes of the applicable nondiscrimination requirement.

These final regulations adopt the provisions of the proposed regulations with only minor modifications, as described below.

2. Changes Made by OBRA '93

a. Lower Limit

Prior to its amendment by OBRA '93, the annual compensation limit was \$200,000 adjusted for cost of living increases (\$235,840 for 1993). Section 401(a)(17) was amended by OBRA '93 to reduce the annual compensation limit to

\$150,000 and to modify the manner in which cost of living adjustments are made to the limit.

b. Annual Adjustment of Compensation Limit

Prior to the effective date of the OBRA '93 changes, the annual compensation limit was increased annually based on the section 415 cost of living adjustment. After the effective date of OBRA '93, the annual compensation limit, as adjusted for changes in the cost of living, is rounded down to the next lowest multiple of \$10,000. Thus, the annual compensation limit increases only when the cost of living adjustment would increase the limit by an increment of at least \$10,000. These final regulations retain the rules in the September 1991 regulations that any increase in the limit is effective for the plan year, or other 12-month period used to determine compensation, commencing in the calendar year for which the limit is adjusted and that the increase applies only to compensation for the year of the increase and subsequent years that are used in determining an employee's benefit.

c. Proration of the Limit

These regulations retain the requirement in the September 1991 regulations that the annual compensation limit must be prorated if compensation for a period of less than 12 months is used for a plan year. However, in response to comments on the proposed regulations, the final regulations clarify that no proration is required merely because the amount of elective contributions, matching contributions, or employee contributions that is contributed for each pay period during a plan year is determined separately using compensation for that pay period. For example, a section 401(k) plan provides each employee with the right to elect to defer up to 6 percent of compensation for a plan year, and then, in accordance with each employee's election for the plan year, contributions are made monthly using the employee's compensation for that pay period. Although the compensation for the plan year that may be taken into account in determining each employee's elective contributions is subject to the annual compensation limit, the compensation for each month would not be required to be limited to \$12,500 ($\frac{1}{12}$ of \$150,000) in this situation.

3. Effective Date and Transition Rules

Section 401(a)(17) is generally effective for plan years beginning on or after January 1, 1989. The changes made

by OBRA '93 are generally effective for plan years beginning on or after January 1, 1994. Special statutory effective dates are provided for collectively bargained plans. In addition, OBRA '93 provides a special grandfather rule for certain eligible participants in governmental plans.

These regulations under section 401(a)(17) are generally effective at the same time that the reduced limit under OBRA '93 applies to the plan. However, in the case of plans maintained by tax-exempt organizations, the regulations are effective for plan years beginning on or after January 1, 1996.

Minor modifications have been made to the examples in these regulations to reflect the OBRA '93 statutory change, the change in the effective date of the regulations from the date in the 1991 regulations, and an employer's choice of complying with the provisions of these regulations prior to the effective date.

a. Fresh-Start Rules

The regulations retain the rule from the September 1991 regulations that benefits accrued or allocations made under a plan for plan years prior to the effective date of section 401(a)(17) are not subject to the annual compensation limit. The regulations also retain the rule in the proposed regulations that the benefits accrued or allocations made under a plan for plan years prior to the effective date of the OBRA '93 changes are not subject to the reduced annual compensation limit.

In order to satisfy the requirements of section 401(a)(17), a defined benefit plan must "fresh start" the benefits of all employees with accrued benefits that are based on compensation that exceeded the annual compensation limit. In order to implement the reduced limit under OBRA '93, a defined benefit plan must again "fresh start" the benefits of all employees with accrued benefits that are based on compensation that exceeded the OBRA '93 \$150,000 compensation limit.

As in the proposed regulations, these final regulations provide guidance on the implementation of these and other multiple fresh starts and coordinate the regulations with the fresh-start rules of the section 401(a)(4) regulations. For example, the regulations continue to cross-reference the section 401(a)(4) regulations for the definition of an employee's frozen accrued benefit. Thus, an employee's frozen accrued benefit as of the OBRA '93 effective date includes benefits accrued as a result of an amendment made within the TRA '86 remedial amendment period that is recognized under section 401(b) as

effective before the OBRA '93 effective date.

b. Amendments to Comply With Section 401(a)(17)

In conjunction with publishing these regulations under section 401(a)(17), the IRS issued Rev. Proc. 94-13, 1994-3 I.R.B. 18, dated January 18, 1994. Rev. Proc. 94-13 provides guidance on the remedial amendment treatment for plans being amended for section 401(a)(17), including guidance on the conditions under which a plan may be amended to comply retroactively with section 401(a)(17) even if the amendment results in a reduction of a benefit protected under section 411(d)(6). Rev. Proc. 94-13 also provides guidance on the extent to which section 204(h) of the Employee Retirement Income Security Act of 1974 (ERISA) will not apply to a plan amendment that limits an employee's compensation taken into account under the plan to the maximum permitted under section 401(a)(17) of the Code.

Commentators requested that this guidance be incorporated into the final regulations. The IRS and the Treasury believe these issues are appropriately addressed in Rev. Proc. 94-13. The guidance under section 411(d)(6) in Rev. Proc. 94-13 is provided pursuant to the specific delegation of authority in § 1.411(d)-4, Q&A-2(b) to the Commissioner to provide, through the publication of revenue rulings, notices, and other documents of general applicability, for the elimination or reduction of section 411(d)(6) protected benefits to the extent that the reduction is necessary to permit compliance with the other requirements of section 401(a). The guidance under section 204(h) of ERISA is provided pursuant to the delegation of authority to the IRS under section 101(a) of Reorganization Plan No. 4 of 1978 (1979-1 C.B. 480) to issue regulations, rulings, opinions, variances, and waivers under section 204 of ERISA.

c. Application of \$150,000 Limit to Accruals or Allocations in Plan Years for Which OBRA '93 is Effective

One commentator suggested that the reduced limit should not apply to compensation for years beginning before the OBRA '93 effective date that is used in determining post-effective date benefit accruals. The regulations, however, continue to provide that benefits accruing, or allocations made, for plan years beginning on or after the OBRA '93 effective date may not take into account compensation for any year in excess of the OBRA '93 annual compensation limit applicable to that

year (generally \$150,000 for years beginning before the OBRA '93 effective date). Thus, compensation for any plan year before OBRA '93 applies to the plan that is used to determine benefits accruing in plan years beginning on or after the OBRA '93 effective date is generally limited to \$150,000. In the absence of this rule, post-effective date accruals under many defined benefit plans would be determined taking into account compensation in excess of \$150,000. For example, this happens when a defined benefit plan determines annual accruals as a percentage of each employee's highest average annual compensation for a specified number of years (including years prior to the effective date of OBRA '93).

d. Collectively Bargained Plans

TRA '86 and OBRA '93 provide a deferred effective date for collectively bargained plans. In response to comments, these regulations clarify that the rules of § 1.410(b)-10(a)(2) apply for purposes of determining whether a plan is a collectively bargained plan. Thus, if a plan is a collectively bargained plan (within the meaning of § 1.410(b)-10(a)(2)(iii)), the deferred effective date applies in determining the plan allocations or benefit accruals of both collectively bargained and noncollectively bargained employees.

e. Governmental Plans

These final regulations retain the special effective date for governmental plans (within the meaning of section 414(d)) in order to provide governmental employers with adequate time to amend their plans to comply with section 401(a)(17). Thus, the regulations provide that these governmental plans will automatically satisfy the requirements of section 401(a)(17) for plan years beginning before the later of January 1, 1996, or 90 days after the opening of the first legislative session beginning on or after January 1, 1996, of the governing body with authority to amend the plan, if that body does not meet continuously.

The final regulations continue to implement the grandfather rule in OBRA '93 for individuals who first became participants in governmental plans before the first plan year beginning after December 31, 1995 or, if earlier, the first plan year for which the plan is amended to comply with OBRA '93. Under the grandfather rule, the annual compensation limit will not apply for those individuals to the extent that the limit would reduce the amount of compensation taken into account under the plan below the amount that was allowed to be taken into account

under the plan as in effect on July 1, 1993. However, in order for this grandfather rule to apply to a plan, the plan must be amended, effective for plan years beginning after December 31, 1995, to incorporate by reference the annual compensation limits of section 401(a)(17) for those participants who are not grandfathered under OBRA '93.

f. Good Faith Compliance Prior to the Regulatory Effective Date

For plan years beginning on or after the date that section 401(a)(17) first applies to a plan, but before these regulations apply to the plan, the plan must be operated in accordance with a reasonable, good faith interpretation of the requirements of section 401(a)(17). Whether compliance is reasonable and in good faith will be determined on the basis of all of the relevant facts and circumstances, including the extent to which the employer has resolved unclear issues in its favor. Reasonable, good faith interpretation will be deemed to exist, however, if a plan is operated in accordance with the 1990 regulations, the September 1991 regulations, the December 1993 regulations, or these regulations. However, for any plan with a regulatory effective date that is later than the OBRA '93 effective date for the plan (e.g., a plan maintained by a tax-exempt organization), a reasonable, good faith interpretation must reflect the OBRA '93 amendments to section 401(a)(17).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these final regulations is Marjorie Hoffman of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.401(a)(17)-1 is revised to read as follows:

§ 1.401(a)(17)-1 Limitation on annual compensation.

(a) *Compensation limit requirement—*
(1) *In general.* In order to be a qualified plan, a plan must satisfy section 401(a)(17). Section 401(a)(17) provides an annual compensation limit for each employee under a qualified plan. This limit applies to a qualified plan in two ways. First, a plan may not base allocations, in the case of a defined contribution plan, or benefit accruals, in the case of a defined benefit plan, on compensation in excess of the annual compensation limit. Second, the amount of an employee's annual compensation that may be taken into account in applying certain specified nondiscrimination rules under the Internal Revenue Code is subject to the annual compensation limit. These two limitations are set forth in paragraphs (b) and (c) of this section, respectively. Paragraph (d) of this section provides the effective dates of section 401(a)(17), the amendments made by section 13212 of the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), and this section. Paragraph (e) of this section provides rules for determining post-effective-date accrued benefits under the fresh-start rules.

(2) *Annual compensation limit for plan years beginning before January 1, 1994.* For purposes of this section, for plan years beginning prior to the OBRA '93 effective date, annual compensation limit means \$200,000, adjusted as provided by the Commissioner. The amount of the annual compensation limit is adjusted at the same time and in the same manner as under section 415(d). The base period for the annual adjustment is the calendar quarter ending December 31, 1988, and the first adjustment is effective on January 1, 1990. Any increase in the annual compensation limit is effective as of January 1 of a calendar year and applies to any plan year beginning in that calendar year. In any plan year

beginning prior to the OBRA '93 effective date, if compensation for any plan year beginning prior to the statutory effective date is used for determining allocations or benefit accruals, or when applying any nondiscrimination rule, then the annual compensation limit for the first plan year beginning on or after the statutory effective date (generally \$200,000) must be applied to compensation for that prior plan year.

(3) *Annual compensation limit for plan years beginning on or after January 1, 1994*—(i) *In general.* For purposes of this section, for plan years beginning on or after the OBRA '93 effective date, annual compensation limit means \$150,000, adjusted as provided by the Commissioner. The adjusted dollar amount of the annual compensation limit is determined by adjusting the \$150,000 amount for changes in the cost of living as provided in paragraph (a)(3)(ii) of this section and rounding this adjusted dollar amount as provided in paragraph (a)(3)(iii) of this section. Any increase in the annual compensation limit is effective as of January 1 of a calendar year and applies to any plan year beginning in that calendar year. For example, if a plan has a plan year beginning July 1, 1994, and ending June 30, 1995, the annual compensation limit in effect on January 1, 1994 (\$150,000), applies to the plan for the entire plan year.

(ii) *Cost of living adjustment.* The \$150,000 amount is adjusted for changes in the cost of living by the Commissioner at the same time and in the same manner as under section 415(d). The base period for the annual adjustment is the calendar quarter ending December 31, 1993.

(iii) *Rounding of adjusted compensation limit.* After the \$150,000, adjusted in accordance with paragraph (a)(3)(ii) of this section, exceeds the annual compensation limit for the prior calendar year by \$10,000 or more, the annual compensation limit will be increased by the amount of such excess, rounded down to the next lowest multiple of \$10,000.

(4) *Additional guidance.* The Commissioner may, in revenue rulings and procedures, notices, and other guidance, published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter), provide any additional guidance that may be necessary or appropriate concerning the annual limits on compensation under section 401(a)(17).

(b) *Plan limit on compensation*—(1) *General rule.* A plan does not satisfy section 401(a)(17) unless it provides that the compensation taken into account for

any employee in determining plan allocations or benefit accruals for any plan year is limited to the annual compensation limit. For purposes of this rule, allocations and benefit accruals under a plan include all benefits provided under the plan, including ancillary benefits.

(2) *Plan-year-by-plan-year requirement.* For purposes of this paragraph (b), the limit in effect for the current plan year applies only to the compensation for that year that is taken into account in determining plan allocations or benefit accruals for the year. The compensation for any prior plan year taken into account in determining an employee's allocations or benefit accruals for the current plan year is subject to the applicable annual compensation limit in effect for that prior year. Thus, increases in the annual compensation limit apply only to compensation taken into account for the plan year in which the increase is effective. In addition, if compensation for any plan year beginning prior to the OBRA '93 effective date is used for determining allocations or benefit accruals in a plan year beginning on or after the OBRA '93 effective date, then the annual compensation limit for that prior year is the annual compensation limit in effect for the first plan year beginning on or after the OBRA '93 effective date (generally \$150,000).

(3) *Application of limit to a plan year*—(i) *In general.* For purposes of applying this paragraph (b), the annual compensation limit is applied to the compensation for the plan year on which allocations or benefit accruals are based.

(ii) *Compensation for the plan year.* If a plan determines compensation used in determining allocations or benefit accruals for a plan year based on compensation for the plan year, then the annual compensation limit that applies to the compensation for the plan year is the limit in effect for the calendar year in which the plan year begins. Alternatively, if a plan determines compensation used in determining allocations or benefit accruals for the plan year on the basis of compensation for a 12-consecutive-month period, or periods, ending no later than the last day of the plan year, then the annual compensation limit applies to compensation for each of those periods based on the annual compensation limit in effect for the respective calendar year in which each 12-month period begins.

(iii) *Compensation for a period of less than 12 months*—(A) *Proration required.* If compensation for a period of less than 12 months is used for a plan year, then the otherwise applicable

annual compensation limit is reduced in the same proportion as the reduction in the 12-month period. For example, if a defined benefit plan provides that the accrual for each month in a plan year is separately determined based on the compensation for that month and the plan year accrual is the sum of the accruals for all months, then the annual compensation limit for each month is $\frac{1}{12}$ th of the annual compensation limit for the plan year. In addition, if the period for determining compensation used in calculating an employee's allocation or accrual for a plan year is a short plan year (i.e., shorter than 12 months), the annual compensation limit is an amount equal to the otherwise applicable annual compensation limit multiplied by a fraction, the numerator of which is the number of months in the short plan year, and the denominator of which is 12.

(B) *No proration required for participation for less than a full plan year.* Notwithstanding paragraph (b)(3)(iii)(A) of this section, a plan is not treated as using compensation for less than 12 months for a plan year merely because the plan formula provides that the allocation or accrual for each employee is based on compensation for the portion of the plan year during which the employee is a participant in the plan. In addition, no proration is required merely because an employee is covered under a plan for less than a full plan year, provided that allocations or benefit accruals are otherwise determined using compensation for a period of at least 12 months. Finally, notwithstanding paragraph (b)(3)(iii)(A) of this section, no proration is required merely because the amount of elective contributions (within the meaning of § 1.401(k)-1(g)(3)), matching contributions (within the meaning of § 1.401(m)-1(f)(12)), or employee contributions (within the meaning of § 1.401(m)-1(f)(6)) that is contributed for each pay period during a plan year is determined separately using compensation for that pay period.

(4) *Limits on multiple employer and multiemployer plans.* For purposes of this paragraph (b), in the case of a plan described in section 413(c) or 414(f) (a plan maintained by more than one employer), the annual compensation limit applies separately with respect to the compensation of an employee from each employer maintaining the plan instead of applying to the employee's total compensation from all employers maintaining the plan.

(5) *Family aggregation.* [Reserved]

(6) *Examples.* The following examples illustrate the rules in this paragraph (b).

Example 1. Plan X is a defined benefit plan with a calendar year plan year and bases benefits on the average of an employee's high 3 consecutive years' compensation. The OBRA '93 effective date for Plan X is January 1, 1994. Employee A's high 3 consecutive years' compensation prior to the application of the annual compensation limits is \$160,000 (1994), \$155,000 (1993), and \$135,000 (1992). To satisfy this paragraph (b), Plan X cannot base plan benefits for Employee A in 1994 on compensation in excess of \$145,000 (the average of \$150,000 (A's 1994 compensation capped by the annual compensation limit), \$150,000 (A's 1993 compensation capped by the \$150,000 annual compensation limit applicable to all years before 1994), and \$135,000 (A's 1992 compensation capped by the \$150,000 annual compensation limit applicable to all years before 1994)). For purposes of determining the 1994 accrual, each year (1994, 1993, and 1992), not the average of the 3 years, is subject to the 1994 annual compensation limit of \$150,000.

Example 2. Assume the same facts as Example 1, except that Employee A's high 3 consecutive years' compensation prior to the application of the limits is \$185,000 (1997), \$175,000 (1996), and \$165,000 (1995). Assume that the annual compensation limit is first adjusted to \$160,000 for plan years beginning on or after January 1, 1997. Plan X cannot base plan benefits for Employee A in 1997 on compensation in excess of \$153,333 (the average of \$160,000 (A's 1997 compensation capped by the 1997 limit), \$150,000 (A's 1996 compensation capped by the 1996 limit), and \$150,000 (A's 1995 compensation capped by the 1995 limit)).

Example 3. Plan Y is a defined benefit plan that bases benefits on an employee's high consecutive 36 months of compensation ending within the plan year. Employee B's high 36 months are the period September 1995 to August 1998, in which Employee B earned \$50,000 in each month. Assume that the annual compensation limit is first adjusted to \$160,000 for plan years beginning on or after January 1, 1997. The annual compensation limit is \$150,000, \$150,000, and \$160,000 in 1995, 1996, and 1997, respectively. To satisfy this paragraph (b), Plan Y cannot base Employee B's plan benefits for the 1998 plan year on compensation in excess of \$153,333. This amount is determined by applying the applicable annual compensation limit to compensation for each of the three 12-consecutive-month periods. The September 1995 to August 1996 period is capped by the annual compensation limit of \$150,000 for 1995; the September 1996 to August 1997 period is capped by the annual compensation limit of \$150,000 for 1996; and the September 1997 to August 1998 period is capped by the annual compensation limit of \$160,000 for 1997. The average of these capped amounts is the annual compensation limit applicable in determining benefits for the 1998 year.

Example 4. (a) Employer P is a partnership. Employer P maintains Plan Z, a profit-sharing plan that provides for an annual allocation of employer contributions of 15 percent of plan year compensation for

employees other than self-employed individuals, and 13.0435 percent of plan year compensation for self-employed individuals. The plan year of Plan Z is the calendar year. The OBRA '93 effective date for Plan Z is January 1, 1994. In order to satisfy section 401(a)(17), as amended by OBRA '93, the plan provides that, beginning with the 1994 plan year, the plan year compensation used in determining the allocation of employer contributions for each employee may not exceed the annual limit in effect for the plan year under OBRA '93. Plan Z defines compensation for self-employed individuals (employees within the meaning of section 401(c)(1)) as the self-employed individual's net profit from self-employment attributable to Employer P minus the amount of the self-employed individual's deduction under section 164(f) for one-half of self-employment taxes. Plan Z defines compensation for all other employees as wages within the meaning of section 3401(a). Employee C and Employee D are partners of Employer P and thus are self-employed individuals. Neither Employee C nor Employee D owns an interest in any other business or is a common-law employee in any business. For the 1994 calendar year, Employee C has net profit from self-employment of \$80,000, and Employee D has net profit from self-employment of \$175,000. The deduction for Employee C under section 164(f) for one-half of self-employment taxes is \$4,828. The deduction for Employee D under section 164(f) for one-half of self-employment taxes is \$6,101.

(b) The plan year compensation under the plan formula for Employee C is \$75,172 (\$80,000 minus \$4,828). The allocation of employer contributions under the plan allocation formula for 1994 for Employee C is \$9,805 (\$75,172 (Employee C's plan year compensation for 1994) multiplied by 13.0435%). The plan year compensation under the plan formula before application of the annual limit under section 401(a)(17) for Employee D is \$168,899 (\$175,000 minus \$6,101). After application of the annual limit, the plan year compensation for the 1994 plan year for Employee D is \$150,000 (the annual limit for 1994). Therefore, the allocation of employer contributions under the plan allocation formula for 1994 for Employee D is \$19,565 (\$150,000 (Employee D's plan year compensation after application of the annual limit for 1994) multiplied by 13.0435%).

Example 5. The facts are the same as in Example 4, except that Plan Z provides that plan year compensation for self-employed individuals is defined as earned income within the meaning of section 401(c)(2) attributable to Employer P. In addition, Plan Z provides for an annual allocation of employer contributions of 15 percent of plan year compensation for all employees in the plan, including self-employed individuals, such as Employees C and D. The net profit from self-employment for Employee C and the net profit from self-employment for Employee D are the same as provided in Example 4. However, the earned income of Employee C determined in accordance with section 401(c)(2) is \$65,367 (\$80,000 minus \$4,828 minus \$9,805). The earned income of Employee D determined in accordance with

section 401(c)(2) is \$146,869 (\$175,000 minus \$6,101 minus \$22,030). Therefore, the allocation of employer contributions under the plan allocation formula for 1994 for Employee C is \$9,805 (\$65,367 (Employee C's plan year compensation for 1994) multiplied by 15%). Employee D's earned income for 1994 does not exceed the 1994 annual limit of \$150,000. Therefore, the allocation of employer contributions under the plan allocation formula for 1994 for Employee D is \$22,030 (\$146,869 (Employee D's plan year compensation for 1994) multiplied by 15%).

(c) **Limit on compensation for nondiscrimination rules—(1) General rule.** The annual compensation limit applies for purposes of applying the nondiscrimination rules under sections 401(a)(4), 401(a)(5), 401(l), 401(k)(3), 401(m)(2), 403(b)(12), 404(a)(2) and 410(b)(2). The annual compensation limit also applies in determining whether an alternative method of determining compensation impermissibly discriminates under section 414(s)(3). Thus, for example, the annual compensation limit applies when determining a self-employed individual's total earned income that is used to determine the equivalent alternative compensation amount under § 1.414(s)-1(g)(1). This paragraph (c) provides rules for applying the annual compensation limit for these purposes. For purposes of this paragraph (c), compensation means the compensation used in applying the applicable nondiscrimination rule.

(2) **Plan-year-by-plan-year requirement.** For purposes of this paragraph (c), when applying an applicable nondiscrimination rule for a plan year, the compensation for each plan year taken into account is limited to the applicable annual compensation limit in effect for that year, and an employee's compensation for that plan year in excess of the limit is disregarded. Thus, if the nondiscrimination provision is applied on the basis of compensation determined over a period of more than one year (for example, average annual compensation), the annual compensation limit in effect for each of the plan years that is taken into account in determining the average applies to the respective plan year's compensation. In addition, if compensation for any plan year beginning prior to the OBRA '93 effective date is used when applying any nondiscrimination rule in a plan year beginning on or after the OBRA '93 effective date, then the annual compensation limit for that prior year is the annual compensation limit for the first plan year beginning on or after the OBRA '93 effective date (generally \$150,000).

(3) *Plan-by-plan limit.* For purposes of this paragraph (c), the annual compensation limit applies separately to each plan (or group of plans treated as a single plan) of an employer for purposes of the applicable nondiscrimination requirement. For this purpose, the plans included in the testing group taken into account in determining whether the average benefit percentage test of § 1.410(b)-5 is satisfied are generally treated as a single plan.

(4) *Application of limit to a plan year.* The rules provided in paragraph (b)(3) of this section regarding the application of the limit to a plan year apply for purposes of this paragraph (c).

(5) *Limits on multiple employer and multiemployer plans.* The rule provided in paragraph (b)(4) of this section regarding the application of the limit to multiple employer and multiemployer plans applies for purposes of this paragraph (c).

(d) *Effective date.*—(1) *Statutory effective date.*—(i) *General rule.* Except as otherwise provided in this paragraph (d), section 401(a)(17) applies to a plan as of the first plan year beginning on or after January 1, 1989. For purposes of this section, statutory effective date generally means the first day of the first plan year that section 401(a)(17) is applicable to a plan. In the case of governmental plans, statutory effective date means the first day of the first plan year for which the plan is not deemed to satisfy section 401(a)(17) by reason of paragraph (d)(4) of this section.

(ii) *Exception for collectively bargained plans.* In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before March 1, 1986, section 401(a)(17) applies to allocations and benefit accruals for plan years beginning on or after the earlier of—

(A) January 1, 1991; or

(B) The later of January 1, 1989, or the date on which the last of the collective bargaining agreements terminates (determined without regard to any extension or renegotiation of any agreement occurring after February 28, 1986). For purposes of this paragraph (d)(1)(ii), the rules of § 1.410(b)-10(a)(2) apply for purposes of determining whether a plan is maintained pursuant to one or more collective bargaining agreements, and any extension or renegotiation of a collective bargaining agreement, which extension or renegotiation is ratified after February 28, 1986, is to be disregarded in determining the date on which the agreement terminates.

(2) *OBRA '93 effective date.*—(i) *In general.* For purposes of this section, OBRA '93 effective date means the first day of the first plan year beginning on or after January 1, 1994, except as provided in this paragraph (d)(2).

(ii) *Exception for collectively bargained plans.*—(A) *In general.* In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and 1 or more employers ratified before August 10, 1993, OBRA '93 effective date means the first day of the first plan year beginning on or after the earlier of—

(1) The latest of—

(i) January 1, 1994;

(ii) The date on which the last of such collective bargaining agreements terminates (without regard to any extension, amendment, or modification of such agreements on or after August 10, 1993); or

(iii) In the case of a plan maintained pursuant to collective bargaining under the Railway Labor Act, the date of execution of an extension or replacement of the last of such collective bargaining agreements in effect on August 10, 1993; or

(2) January 1, 1997.

(B) *Determination of whether plan is collectively bargained.* For purposes of this paragraph (d)(2)(ii), the rules of § 1.410(b)-10(a)(2) apply for purposes of determining whether a plan is maintained pursuant to one or more collective bargaining agreements, except that August 10, 1993, is substituted for March 1, 1986, as the date before which the collective bargaining agreements must be ratified.

(3) *Regulatory effective date.* This § 1.401(a)(17)-1 applies to plan years beginning on or after the OBRA '93 effective date. However, in the case of a plan maintained by an organization that is exempt from income taxation under section 501(a), including plans subject to section 403(b)(12)(A)(i) (nonelective plans), this § 1.401(a)(17)-1 applies to plan years beginning on or after January 1, 1996. For plan years beginning before the effective date of these regulations and on or after the statutory effective date, a plan must be operated in accordance with a reasonable, good faith interpretation of section 401(a)(17), taking into account, if applicable, the OBRA '93 reduction to the annual compensation limit under section 401(a)(17).

(4) *Special rules for governmental plans.*—(i) *Deemed satisfaction by governmental plans.* In the case of governmental plans described in section 414(d), including plans subject to section 403(b)(12)(A)(i) (nonelective

plans), section 401(a)(17) is considered satisfied for plan years beginning before the later of January 1, 1996, or 90 days after the opening of the first legislative session beginning on or after January 1, 1996, of the governing body with authority to amend the plan, if that body does not meet continuously. For purposes of this paragraph (d)(4), the term governing body with authority to amend the plan means the legislature, board, commission, council, or other governing body with authority to amend the plan.

(ii) *Transition rule for governmental plans.*—(A) *In general.* In the case of an eligible participant in a governmental plan (within the meaning of section 414(d)), the annual compensation limit under this section shall not apply to the extent that the application of the limitation would reduce the amount of compensation that is allowed to be taken into account under the plan below the amount that was allowed to be taken into account under the plan as in effect on July 1, 1993. Thus, for example, if a plan as in effect on July 1, 1993, determined benefits without any reference to a limit on compensation, then the annual compensation limit in effect under this section will not apply to any eligible participant in any future year.

(B) *Eligible participant.* For purposes of this paragraph (d)(4)(ii), an eligible participant is an individual who first became a participant in the plan prior to the first day of the first plan year beginning after the earlier of—

(1) The last day of the plan year by which a plan amendment to reflect the amendments made by section 13212 of OBRA '93 is both adopted and effective; or

(2) December 31, 1995.

(C) *Plan must be amended to incorporate limits.* This paragraph (d)(4)(ii) shall not apply to any eligible participant in a plan unless the plan is amended so that the plan incorporates by reference the annual compensation limit under section 401(a)(17), effective with respect to noneligible participants for plan years beginning after December 31, 1995 (or earlier, if the plan amendment so provides).

(5) *Benefits earned prior to effective date.*—(i) *In general.* Allocations under a defined contribution plan or benefits accrued under a defined benefit plan for plan years beginning before the statutory effective date are not subject to the annual compensation limit. Allocations under a defined contribution plan or benefits accrued under a defined benefit plan for plan years beginning on or after the statutory effective date, but before the OBRA '93

effective date, are subject to the annual compensation limit under paragraph (a)(2) of this section. However, these allocations or accruals are not subject to the OBRA '93 reduction to the annual compensation limit described in paragraph (a)(3) of this section.

(ii) *Allocation for a plan year.* The allocations for a plan year include amounts described in § 1.401(a)(4)-2(c)(ii) or § 1.401(m)-1(f)(6) plus the earnings, expenses, gains, and losses attributable to those amounts.

(iii) *Benefits accrued for years before the effective date.* The benefits accrued for plan years prior to a specified date by any employee are the employee's benefits accrued under the plan, determined as if those benefits had been frozen (as defined in § 1.401(a)(4)-13(c)(3)(i)) as of the day immediately preceding such specified date. Thus, for example, benefits accrued for those plan years generally do not include any benefits accrued under an amendment increasing prior benefits that is adopted after the date on which the employee's benefits under the plan must be treated as frozen.

(e) *Determination of post-effective-date accrued benefits—(1) In general.* The plan formula that is used to determine the amount of allocations or benefit accruals for plan years beginning on or after the dates described in paragraph (d)(1) or (2) must comply with section 401(a)(17) as in effect on such date. This paragraph (e) provides rules for applying section 401(a)(17) in the case of section 401(a)(17) employees who accrue additional benefits under a defined benefit plan in a plan year beginning on or after the relevant effective date. Paragraph (e)(2) of this section contains definitions used in applying these rules. Paragraphs (e)(3) and (e)(4) of this section explain the application of the fresh-start rules in § 1.401(a)(4)-13 to the determination of the accrued benefits of section 401(a)(17) employees.

(2) *Definitions.* For purposes of this paragraph (e), the following definitions apply:

(i) *Section 401(a)(17) employee.* An employee is a section 401(a)(17) employee as of a date, on or after the statutory effective date, if the employee's current accrued benefit as of that date is based on compensation for a year prior to the statutory effective date that exceeded the annual compensation limit for the first plan year beginning on or after the statutory effective date. In addition, an employee is a section 401(a)(17) employee as of a date, on or after the OBRA '93 effective date, if the employee's current accrued benefit as of that date is based on

compensation for a year prior to the OBRA '93 effective date that exceeded the annual compensation limit for the first plan year beginning on or after the OBRA '93 effective date. For this purpose, a current accrued benefit is not treated as based on compensation that exceeded the relevant annual compensation limit, if a plan makes a fresh start using the formula with wear-away described in § 1.401(a)(4)-13(c)(4)(ii), and the employee's accrued benefit determined under § 1.401(a)(4)-13(c)(4)(ii)(B), taking into account the annual compensation limit, exceeds the employee's frozen accrued benefit (or, if applicable, the employee's adjusted accrued benefit) as of the fresh-start date.

(ii) *Section 401(a)(17) fresh-start date.* Section 401(a)(17) fresh-start date means a fresh-start date as defined in § 1.401(a)(4)-12 not earlier than the last day of the last plan year beginning before the statutory effective date, and not later than the last day of the last plan year beginning before the effective date of these regulations.

(iii) *OBRA '93 fresh-start date.* OBRA '93 fresh-start date means a fresh-start date as defined in § 1.401(a)(4)-12 not earlier than the last day of the last plan year beginning before the OBRA '93 effective date, and not later than the last day of the last plan year beginning before the effective date of these regulations.

(iv) *Section 401(a)(17) frozen accrued benefit.* Section 401(a)(17) frozen accrued benefit means the accrued benefit for any section 401(a)(17) employee frozen (as defined in § 1.401(a)(4)-13(c)(3)(i)) as of the last day of the last plan year beginning before the statutory effective date.

(v) *OBRA '93 frozen accrued benefit.* OBRA '93 frozen accrued benefit means the accrued benefit for any section 401(a)(17) employee frozen (as defined in § 1.401(a)(4)-13(c)(3)(i)) as of the OBRA '93 fresh-start date.

(3) *Application of fresh-start rules—(i) General rule.* In order to satisfy section 401(a)(17), a defined benefit plan must determine the accrued benefit of each section 401(a)(17) employee by applying the fresh-start rules in § 1.401(a)(4)-13(c). The fresh-start rules must be applied using a section 401(a)(17) fresh-start date and using the plan benefit formula, after amendment to comply with section 401(a)(17) and this section, as the formula applicable to benefit accruals in the current plan year. In addition, the fresh-start rules must be applied to determine the accrued benefit of each section 401(a)(17) employee using an OBRA '93 fresh-start date and using the plan benefit formula, after

amendment to comply with the reduction in the section 401(a)(17) annual compensation limit described in paragraph (a)(3) of this section, as the formula applicable to benefit accruals in the current plan year.

(ii) *Consistency rules in § 1.401(a)(4)-13(c) and (d)—(A) General rule.* In applying the fresh-start rules of § 1.401(a)(4)-13(c) and (d), the group of section 401(a)(17) employees is a fresh-start group. See § 1.401(a)(4)-13(c)(5)(ii)(A). Thus, the consistency rules of those sections govern, unless otherwise provided. For example, if the plan is using a fresh-start date applicable to all employees and is not adjusting frozen accrued benefits under § 1.401(a)(4)-13(d) for employees who are not section 401(a)(17) employees, then the frozen accrued benefits for section 401(a)(17) employees may not be adjusted under § 1.401(a)(4)-13(d) or this paragraph (e).

(B) *Determination of adjusted accrued benefit.* If the fresh-start rules of § 1.401(a)(4)-13(c) and (d) are applied to determine the benefits of all employees after a fresh-start date, the plan will not fail to satisfy the consistency requirement of § 1.401(a)(4)-13(c)(5)(i) merely because the plan makes the adjustment described in § 1.401(a)(4)-13(d) to the frozen accrued benefits of employees who are not section 401(a)(17) employees, but does not make the adjustment to the frozen accrued benefits of section 401(a)(17) employees. In addition, the plan does not fail to satisfy the consistency requirement of § 1.401(a)(4)-13(c)(5)(i) merely because the plan makes the adjustment described in § 1.401(a)(4)-13(d) for section 401(a)(17) employees on the basis of the compensation formula that was used to determine the frozen accrued benefit (as required under paragraph (e)(4)(iii) of this section) but makes the adjustment for employees who are not section 401(a)(17) employees on the basis of any other method provided in § 1.401(a)(4)-13(d)(8).

(4) *Permitted adjustments to frozen accrued benefit of section 401(a)(17) employees—(i) General rule.* Except as otherwise provided in paragraphs (e)(4)(ii) and (iii) of this section, the rules in § 1.401(a)(4)-13(c)(3) (permitting certain adjustments to frozen accrued benefits) apply to section 401(a)(17) frozen accrued benefits or OBRA '93 frozen accrued benefits.

(ii) *Optional forms of benefit.* After either the section 401(a)(17) fresh-start date or the OBRA '93 fresh-start date, a plan may be amended either to provide a new optional form of benefit or to make an optional form of benefit

available with respect to the section 401(a)(17) frozen accrued benefit or the OBRA '93 frozen accrued benefit, provided that the optional form of benefit is not subsidized. Whether an optional form is subsidized may be determined using any reasonable actuarial assumptions.

(iii) *Adjusting section 401(a)(17) accrued benefits—(A) In general.* If the plan adjusts accrued benefits for employees under the rules of § 1.401(a)(4)–13(d) as of a fresh-start date, the adjusted accrued benefit (within the meaning of section 401(a)(17) employee must be determined after the fresh-start date by reference to the plan's compensation formula that was actually used to determine the frozen accrued benefit as of the fresh-start date. For this purpose, the plan's compensation formula incorporates the plan's underlying compensation definition and compensation averaging period. In making the adjustment, the denominator of the adjustment fraction described in § 1.401(a)(4)–13(d)(8)(i) is the employee's compensation as of the fresh-start date using the plan's compensation formula as of that date and, in the case of an OBRA '93 fresh-start date, reflecting the annual compensation limits that applied as of the fresh-start date. The numerator of the adjustment fraction is the employee's updated compensation (i.e., compensation for the current plan year within the meaning of § 1.401(a)(4)–13(d)(8)), determined after applying the annual compensation limits to each year's compensation that is used in the plan's compensation formula as of the fresh-start date. Similarly, in applying the alternative rule in § 1.401(a)(4)–13(d)(8)(v), the updated compensation that is substituted must be determined after applying the annual compensation limits to each year's compensation that is used in the plan's compensation formula. Thus, no adjustment will be permitted unless the updated compensation (determined after applying the annual compensation limit) exceeds the compensation that was used to determine the employee's frozen accrued benefit.

(B) *Multiple fresh starts.* If a plan makes more than one fresh start with respect to a section 401(a)(17) employee, the employee's frozen accrued benefit as of the latest fresh-start date will either be determined by applying the current benefit formula to the employee's total years of service as of that fresh-start date or will consist of the sum of the employee's frozen accrued benefit (or adjusted accrued benefit (as defined in

§ 1.401(a)(4)–13(d)(8)(i))) as of the previous fresh-start date plus additional frozen accruals since the previous fresh start. If the frozen accrued benefit consists of such a sum, in making the adjustments described in paragraph (e)(4)(iii)(A) of this section, separate adjustments must be made to that previously frozen accrued benefit (or adjusted accrued benefit) and the additional frozen accruals to the extent that the frozen accrued benefit and the additional accruals have been determined using different compensation formulas or different compensation limits (i.e., the section 401(a)(17) limit before and after the reduction in limit described in paragraph (a)(3) of this section). In this case, if the plan is applying the adjustment fraction of § 1.401(a)(4)–13(d)(8)(i), the denominator of the separate adjustment fraction for adjusting each portion of the frozen accrued benefit must reflect the actual compensation formula, and, if applicable, compensation limit, originally used for determining that portion. For example, the frozen accrued benefit of a section 401(a)(17) employee as of the OBRA '93 fresh-start date may be based on the sum of the section 401(a)(17) frozen accrued benefit (determined without any annual compensation limit) plus benefit accruals in the years between the statutory effective date and the OBRA '93 effective date (based on compensation that was subject to the annual compensation limits for those years). In this example, in adjusting the section 401(a)(17) frozen accrued benefit, the denominator of the adjustment fraction does not reflect any annual compensation limit. Similarly, in adjusting the frozen accruals for years between the statutory effective date and the OBRA '93 effective date, the denominator of the adjustment fraction reflects the level of the annual compensation limit in effect for those years.

(5) *Examples.* The following examples illustrate the rules in this paragraph (e).

Example 1. (a) Employer X maintains Plan Y, a calendar year defined benefit plan providing an annual benefit for each year of service equal to 2 percent of compensation averaged over an employee's high 3 consecutive calendar years' compensation. Section 401(a)(17) applies to Plan Y in 1989. As of the close of the last plan year beginning before January 1, 1989 (i.e., the 1988 plan year), Employee A, with 5 years of service, had accrued a benefit of \$25,000 which equals 10 percent (2 percent multiplied by 5 years of service) of average compensation of \$250,000. Employer X decides to comply with the provisions of this section for plan years before the effective date of this section.

Employer X decides to make the amendment effective for plan years beginning on or after January 1, 1989, and uses December 31, 1988 as the section 401(a)(17) fresh-start date. Plan Y, as amended, provides that, in determining an employee's benefit, compensation taken into account is limited in accordance with the provisions of this section to the annual compensation limit under section 401(a)(17), and that, for section 401(a)(17) employees, the employee's accrued benefit is the greater of

(i) The employee's benefit under the plan's benefit formula (after the plan formula is amended to comply with section 401(a)(17)) as applied to the employee's total years of service; and

(ii) The employee's accrued benefit as of December 31, 1988, determined as though the employee terminated employment on that date without regard to any plan amendments after that date.

Employer X decides not to amend Plan Y to provide for the adjustments permitted under § 1.401(a)(4)–13(d) to the accrued benefit of section 401(a)(17) employees as of December 31, 1988.

(b) Under Plan Y, Employee A's accrued benefit at the end of 1989 is \$25,000, which is the greater of Employee A's accrued benefit as of the last day of the 1988 plan year (\$25,000), and \$24,000, which is Employee A's benefit based on the plan's benefit formula applied to Employee A's total years of service (\$200,000 multiplied by (2 percent multiplied by 6 years of service)). The formula of Plan Y applicable to section 401(a)(17) employees for calculating their accrued benefits for years after the section 401(a)(17) fresh-start date is the formula in § 1.401(a)–13(c)(4)(ii) (formula with wear-away). The fresh-start formula is applied using a benefit formula for the 1989 plan year that satisfies section 401(a)(17) and this section, and the December 31, 1988 fresh-start date used for the plan is a section 401(a)(17) fresh-start date within the meaning of paragraph (e)(2)(ii) of this section. Thus, Plan Y, as amended, satisfies paragraph (e)(3)(i) of this section for plan years commencing prior to the OBRA '93 effective date.

Example 2. Assume the same facts as in Example 1, except that the plan formula provides that effective January 1, 1989, for section 401(a)(17) employees, an employee's benefit will equal the sum of the employee's accrued benefit as of December 31, 1988 (determined as though the employee terminated employment on that date and without regard to any amendments after that date), and 2 percent of compensation averaged over an employee's high 3 consecutive years' compensation times years of service taking into account only years of service after December 31, 1988. Thus, under Plan Y's formula, Employee A's accrued benefit as of December 31, 1989 is \$29,000, which is equal to the sum of \$25,000 (Employee A's accrued benefit as of December 31, 1988) plus \$4,000 (\$200,000 multiplied by (2 percent multiplied by 1 year of service)). The formula of Plan Y applicable to section 401(a)(17) employees for calculating their accrued benefits for years after the section 401(a)(17) fresh-start date is

the formula in § 1.401(a)-13(c)(4)(i) (formula without wear-away). The fresh-start formula is applied using a benefit formula for the 1989 plan year that satisfies section 401(a)(17) and this section, and the December 31, 1988 fresh-start date used for the plan is a section 401(a)(17) fresh-start date within the meaning of paragraph (e)(2)(ii) of this section. Thus, Plan Y, as amended, satisfies paragraph (e)(3)(i) of this section for plan years commencing prior to the OBRA '93 effective date.

Example 3. (a) Assume the same facts as in Example 1, except that the plan formula provides that effective January 1, 1989, an employee's benefit equals the greater of the plan formulas in Example 1 and Example 2. The formula of Plan Y applicable to section 401(a)(17) employees for calculating their accrued benefits for years after the section 401(a)(17) fresh-start date is the formula in § 1.401(a)-13(c)(4)(iii) (formula with extended wear-away). The fresh-start formula is applied using a benefit formula for the 1989 plan year that satisfies section 401(a)(17) and this section, and the December 31, 1988 fresh-start date used for the plan is a section 401(a)(17) fresh-start date within the meaning of paragraph (e)(2)(ii) of this section. Thus, Plan Y, as amended, satisfies paragraph (e)(3)(i) of this section for plan years commencing prior to the OBRA '93 effective date.

(b) Assume that for each of the years 1991-93 Employee A's annual compensation under the plan compensation formula, disregarding the amendment to comply with section 401(a)(17) is \$300,000. The annual compensation limit is adjusted to \$222,220, \$228,860, and \$235,840 for plan years beginning January 1, 1991, 1992, and 1993, respectively. Because Employer X has decided to amend Plan Y to comply with the provisions of this section effective for plan years beginning on or after January 1, 1989, and has used December 31, 1988 as the section 401(a)(17) fresh-start date, the compensation that may be taken into account for plan benefits in 1993 cannot exceed \$228,973 (the average of \$222,220, \$228,860, and \$235,840). Therefore, as of December 31, 1993, the benefit determined under the fresh-start formula with wear-away would be \$45,795 (\$228,973 multiplied by 2 percent multiplied by 10 years of service). The benefit determined under the fresh-start formula without wear-away would be \$47,897, which is equal to \$25,000 (Employee A's section 401(a)(17) frozen accrued benefit) plus \$22,897 (\$228,973 multiplied by 2 percent multiplied by 5 years of service). Because Employee A's accrued benefit is being determined using the fresh-start formula with extended wear-away, Employee A's accrued benefit as of December 31, 1993, is equal to \$47,897, the greater of the two amounts.

Example 4. (a) Assume the same facts as in Example 3, except that Plan Y satisfies § 1.401(a)(4)-13(d)(3) through (d)(7) and that the amendment to Plan Y effective for plan years beginning after December 31, 1988, also provided for adjustments to the section 401(a)(17) frozen accrued benefit in accordance with § 1.401(a)(4)-13(d) using the fraction described in § 1.401(a)(4)-13(d)(8)(i).

(b) As of December 31, 1993, the numerator of Employee A's compensation fraction is \$228,973 (the average of Employee A's annual compensation for 1991, 1992, and 1993, as limited by the respective annual limit for each of those years). The denominator of Employee A's compensation fraction determined in accordance with paragraph (e)(4)(iii) of this section is \$250,000 (the average of Employee A's high 3 consecutive calendar year compensation as of December 31, 1988, determined without regard to section 401(a)(17)). Therefore, Employee A's compensation fraction is \$228,973/\$250,000. Because the compensation adjustment fraction is less than 1, Employee A's section 401(a)(17) frozen accrued benefit is not adjusted. Therefore, Employee A's accrued benefit as of December 31, 1993, would still be \$47,897, which is equal to \$25,000 (Employee A's section 401(a)(17) frozen accrued benefit) plus \$22,897 (\$228,973 multiplied by 2 percent multiplied by 5 years of service).

Example 5. (a) Assume the same facts as in Example 3, except that as of January 1, 1994, Plan Y is amended to provide that benefits will be determined based on compensation of \$150,000 (the limit in effect under section 401(a)(17) for plan years beginning on or after the OBRA '93 effective date) and that for section 401(a)(17) employees, each employee's accrued benefit will be determined under § 1.401(a)(4)-13(c)(4)(i) (formula without wear-away) using December 31, 1993 as the OBRA '93 fresh-start date.

(b) Assume that for each of the years 1996-98 Employee A's annual compensation under the plan compensation definition, disregarding the amendment to comply with section 401(a)(17), is \$400,000. Assume that the annual compensation limit is first adjusted to \$160,000 for plan years beginning on or after January 1, 1997, and is not adjusted for the plan year beginning on or after January 1, 1998. The compensation that may be taken into account for the 1998 plan year cannot exceed \$156,667 (the average of \$150,000 for 1996, \$160,000 for 1997, and \$160,000 for 1998).

(c) Therefore, at the end of December 31, 1998, Employee A's accrued benefit is \$63,564, which is equal to \$47,897 (Employee A's OBRA '93 frozen accrued benefit) plus \$15,667 (\$156,667 multiplied by 2 percent multiplied by 5 years of service).

Example 6. (a) Assume the same facts as in Example 5, except that, for the fresh-start group (in this case the section 401(a)(17) employees), the amendments to Plan Y provide for adjustments to the section 401(a)(17) frozen accrued benefit and the OBRA '93 frozen accrued benefit in accordance with § 1.401(a)(4)-13(d) using the fraction described in § 1.401(a)(4)-13(d)(8)(i).

(b) Employee A's frozen accrued benefit as of December 31, 1993, is adjusted as of December 31, 1998, as follows:

(1) Employee A's frozen accrued benefit as of December 31, 1993, is the sum of Employee A's section 401(a)(17) frozen accrued benefit (\$25,000) and Employee A's frozen accruals for the years 1989-93 (\$22,897).

(2) The numerator of Employee A's adjustment fraction is \$156,667 (the average

of \$150,000, \$160,000, and \$160,000). The denominator of Employee A's adjustment fraction with respect to Employee A's section 401(a)(17) frozen accrued benefit is \$250,000, and the denominator of Employee A's adjustment fraction with respect to the rest of Employee A's frozen accrued benefit is \$228,973 (the average of Employee A's annual compensation for 1991, 1992, and 1993, as limited by the respective annual limit for each of those years).

(3) Employee A's section 401(a)(17) frozen accrued benefit as adjusted through December 31, 1998, remains \$25,000. The compensation adjustment fraction determined in accordance with paragraph (e)(4)(iii) of this section is less than one (\$156,667 divided by \$250,000).

(4) Employee A's frozen accruals for the years 1989-93, as adjusted through December 31, 1998, remain \$22,897 because the adjustment fraction is less than one (\$156,667 divided by \$228,973).

(5) Employee A's adjusted accrued benefit as of December 31, 1998, equals \$47,897 (the sum of the \$25,000 and \$22,897 amounts from paragraphs (b)(3) and (b)(4), respectively, of this Example).

(c) Employee A's section 401(a)(17) frozen accrued benefit will not be adjusted for compensation increases until the numerator of the fraction used to adjust that frozen accrued benefit exceeds the denominator of \$250,000 used in determining those accruals.

Similarly, the portion of Employee A's OBRA '93 frozen accrued benefit attributable to the frozen accruals for the years 1989-1993 will not be adjusted for compensation increases until the numerator of the fraction used to adjust those frozen accruals exceeds the denominator of \$228,973 used in determining those accruals.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: June 14, 1994.

Leslie Samuels,
Assistant Secretary of the Treasury.
[FR Doc. 94-15440 Filed 6-23-94; 8:45 am]
BILLING CODE 4830-01-U

26 CFR Part 1

[TD 8548]

RIN 1545-AR61

Qualified Separate Lines of Business

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains amendments to the final regulations under section 414(r) of the Internal Revenue Code, which provide that an employer may be treated as operating separate lines of business for purposes of applying the minimum coverage requirements of section 410(b) and the minimum participation requirements of section 401(a)(26). The regulations reflect the enactment of section 414(i)

by the Tax Reform Act of 1986 and subsequent changes made by the Technical and Miscellaneous Revenue Act of 1988 and the Public Debt Limit Increase Act of 1989. The regulations provide guidance necessary to comply with the law and affect sponsors of and participants in tax-qualified retirement plans and certain other employee benefit plans.

DATES: These regulations are effective January 1, 1994.

The regulations apply to plan years beginning on or after January 1, 1994, except as provided in the transition rules of § 1.414(r)-1(d)(9).

FOR FURTHER INFORMATION CONTACT: Patricia McDermott at (202) 622-4606 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Proposed regulations under section 414(r) and related provisions of the Internal Revenue Code (Code) were published in the *Federal Register* on February 1, 1991 (56 FR 3988). Written comments were received from the public on the proposed regulations. In addition, a public hearing on the proposed regulations was held on May 16, 1991. After consideration of all the written comments received and the statements made at the public hearing, the proposed regulations under section 414(r) were adopted, as modified, by final regulations (TD 8376) published in the *Federal Register* on December 4, 1991 (56 FR 63420). On August 10, 1992, proposed regulations were published in the *Federal Register* (57 FR 35536) to extend the effective date of the final regulations under section 414(r) (and related regulations), generally to plan years beginning on or after January 1, 1994.

On September 7, 1993, proposed regulations amending the final regulations under sections 414(r) and 410(b) were published in the *Federal Register* (58 FR 47090). Written comments were received from the public on the proposed regulations, and a public hearing was held on November 10, 1993. After consideration of all the written comments received and the statements made at the public hearing, these regulations are adopted as modified by this Treasury decision.

Temporary regulations (TD 8173) and proposed regulations under section 414(q) of the Code (relating to the definition of highly compensated employee) were published in the *Federal Register* on February 19, 1988 (53 FR 4965 and 4999). In conjunction with the February 1991 proposed regulations under section 414(r),

amendments to the temporary regulations (TD 8334) and proposed regulations under section 414(q) were published in the *Federal Register* on February 1, 1991 (56 FR 3976 and 4023). The amendments related to the employee exclusions for purposes of satisfying the 50-employee requirement for a separate line of business under section 414(r)(2)(A) of the Code.

Under section 7805(e)(2) of the Code, the February 1991 amendments to the temporary regulations under section 414(q) expired after three years (January 31, 1994). In order to retain the application of those rules, the February 1991 proposed regulations under section 414(q) are adopted by this Treasury decision.

Explanation of Provisions

1. Overview

In general, all employees of a single employer, determined under section 414 of the Code, are taken into account for purposes of applying the minimum coverage requirements of section 410(b) and the minimum participation requirements of section 401(a)(26) to a qualified plan. Section 410(b)(5) provides an exception if an employer operates qualified separate lines of business under section 414(r). If the employer is treated as operating qualified separate lines of business, section 410(b)(5) generally permits the employer to apply the minimum coverage requirements separately with respect to the employees of each qualified separate line of business. A similar exception is provided for purposes of applying the minimum participation requirements of section 401(a)(26) and the 55-percent average benefits test of section 129(d)(8).

An employer is treated as operating qualified separate lines of business if (1) the employer designates its lines of business by reference to the property or services provided by each line, (2) each line of business is organized and operated separately from the remainder of the employer, and (3) each of these separate lines of business meets additional statutory requirements (including administrative scrutiny) and thus constitutes a qualified separate line of business. Each employee of an employer that operates qualified separate lines of business is assigned to a particular line of business for purposes of nondiscrimination testing.

The September 1993 proposed regulations amend the final regulations under section 414(r) generally to address issues raised since the publication of the final regulations. The

proposed regulations include the following major changes:

- Allowing an employee to be treated as a substantial-service employee with respect to a line of business if at least 50 percent of the employee's services are provided to that line.
- Applying the separate management and separate workforce tests to a line of business without regard to substantial-service employees of other lines.
- Excluding nonresident aliens in applying the separate management and separate workforce tests.
- Expanding the special rules for vertically integrated lines of business and transferred employees.
- Increasing access to individual determinations under administrative scrutiny.
- Clarifying the treatment of employees who change from one disaggregation population to another.

In general, comments received on the changes included in the proposed regulations were favorable. Accordingly, these final regulations incorporate those changes. In addition, in response to comments, certain further modifications have been made to the regulations. The more significant modifications are discussed below.

2. Residual Shared employees

Most of the comments received on the September 1993 proposed regulations pertained to the allocation of residual shared employees, that is, employees who provide services to more than one qualified separate line of business and who are not substantial-service employees with respect to any line of business. The December 1991 regulations provide three alternative allocation methods for residual shared employees, which are intended to assure that, as a group, residual shared employees receive benefits representative of the benefits provided to the workforce generally.

Under the dominant line of business method, all residual shared employees are allocated to the employer's dominant line of business. Generally, a qualified separate line of business is dominant if at least 50 percent of the employer's substantial-service employees are assigned to that line. Alternatively, a line of business may be dominant if at least 35 percent of the employer's substantial-service employees are assigned to that line and the line satisfies any one of four possible conditions, such as a certain level of revenue or a certain size compared with the employer's other lines. The other two allocation methods,

the pro-rata method and the highly compensated employee (HCE) percentage ratio method, provide formulas under which residual shared employees are allocated among the employer's various qualified separate lines of business.

Employers have commented that the allocation rules do not adequately accommodate current benefit arrangements for employees who provide services to more than one qualified separate line of business. For example, the employer might cover residual shared employees in the plan maintained for a line that the employer considers its core business, even though that line does not satisfy the dominant line of business standard. Residual shared employees therefore cannot all be allocated to that line, potentially causing a change in their benefits. Employers also have commented that the pro-rata and HCE percentage ratio methods may require employees in the same department to be allocated to different qualified separate lines of business, which in turn may require different benefits to be provided to employees who work together.

In response to comments, these final regulations change the allocation rules in two ways. First, the standard for the alternative test of dominance is lowered from 35 percent to 25 percent, giving employers more flexibility in establishing a dominant line. Second, the regulations provide an additional allocation alternative, the small group method.

Under the small group method, with respect to each residual shared employee, the employer chooses a qualified separate line of business to which the employee is allocated. The residual shared employees need not all be allocated to the same qualified separate line of business; the employer thus has great flexibility in selecting the plans under which residual shared employees benefit. In order to prevent this new allocation method from being used to provide highly compensated employees with excessive benefits relative to the nonhighly compensated employees, its use is subject to three requirements.

First, the entire group of the employer's residual shared employees cannot exceed three percent of the employees taken into account in applying section 410(b). In addition, the qualified separate line of business to which the employer allocates a residual shared employee must include at least 10 percent of the employer's substantial-service employees and must satisfy the administrative scrutiny statutory safe harbor after the allocation, that is, the

concentration of highly compensated employees in the line of business must be between 50 and 200 percent of the concentration of highly compensated employees in the workforce generally. Finally, the allocation of residual shared employees must be reasonable; criteria for determining whether an allocation is reasonable are set forth in the regulations.

3. Gateway

Section 410(b)(5)(B) provides that separate-line-of-business testing does not apply to a plan unless the plan benefits such employees as qualify under a classification that is set up by the employer and is found not to discriminate in favor of highly compensated employees. Because the employer-wide nondiscriminatory classification test of section 410(b)(5)(B) is a prerequisite to separate-line-of-business testing, it is sometimes referred to as the "Gateway."

Under the December 1991 regulations, the Gateway is applied in the same basic manner as the nondiscriminatory classification test under the section 410(b) regulations. Those regulations establish an unsafe harbor ratio percentage for a plan, that is, a minimum ratio of the relative coverage rates of nonhighly compensated and highly compensated employees. The unsafe harbor percentage applicable to a plan depends on the concentration of nonhighly compensated employees in the employer's workforce.

If a qualified separate line of business has a disproportionate share of the employer's highly compensated employees, the plan maintained for that line of business may have a very low ratio percentage on an employer-wide basis, even though it covers a high percentage of the nonhighly compensated employees in that line. The December 1991 regulations therefore provide a reduced unsafe harbor percentage if the plan has a ratio percentage of at least 90 percent on a qualified-separate-line-of-business basis. Although most plans pass the Gateway test in its current form, some commentators on the September 1993 proposed regulations have noted continued difficulty in the case of plans maintained for certain lines of business that cover a high percentage of the nonhighly compensated employees in those lines.

In response to those comments, these final regulations provide that, if a plan has a ratio percentage of at least 90 percent on a qualified-separate-line-of-business basis, but its employer-wide ratio percentage falls below the plan's reduced unsafe harbor percentage, the

plan nonetheless is deemed to satisfy section 410(b)(5)(B) on an employer-wide basis if the Commissioner determines that, based on all of the relevant facts and circumstances, the plan benefits such employees as qualify under a classification of employees that does not discriminate in favor of highly compensated employees. For this purpose, included among the relevant facts and circumstances are facts and circumstances such as those listed in § 1.410(b)-4(c)(3)(ii). In making these determinations, the Commissioner will determine which other facts and circumstances are relevant, including any of the facts and circumstances listed in section 5 of Rev. Proc. 93-41, 1993-2 C.B. 536, that the Commissioner determines are relevant.

4. Other Changes

These final regulations also make the following changes:

- Expansion of the minimum and maximum benefit safe harbor to apply to career average plans.
- Allowing more flexibility in the employees taken into account for purposes of the minimum benefit safe harbor.
- Clarification of the application of section 401(a)(26) to employer-wide plans.
- Clarification of the disaggregation population rules after a change in disaggregation population groups.
- Finalization of the regulations under section 414(q) relating to employees excluded for purposes of the 50-employee requirement under section 414(r)(2)(A).

5. Notice 92-36 relief

A concern has been raised that the anti-cutback rules of section 411(d)(6) might eliminate an employer's option to comply with the nondiscrimination requirements of the Tax Reform Act of 1986 (including the provisions of section 414(r)) and related legislation by amending its plans in the 1994 plan year to reduce the level of benefits provided to highly compensated employees for that year. Employers are reminded that Notice 92-36, 1992-2 C.B. 364, provided broad transition relief giving employers the opportunity to retain their amendment options until the last day of the 1994 plan year without being treated as violating section 411(d)(6).

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has

been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Patricia McDermott of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805. * * *

Section 1.414(q)-1 also issued under 26 U.S.C. 414(q). * * *

Par. 2. Section 1.410(b)-0 is amended as follows:

1. The entries for § 1.410(b)-7(c)(4) and (c)(5) are revised.
2. The entry for (c)(6) is removed.
3. The revised entries read as follows:

§ 1.410(b)-0 Table of Contents. * * *

* * * * *

§ 1.410(b)-7 Definition of plan and rules governing plan disaggregation and aggregation.

* * * * *

(c) * * *

(4) Plans benefiting certain disaggregation populations of employees.

- (i) In general.
- (ii) Definition of disaggregation population.
- (5) Additional rules for plans benefiting employees of more than one qualified separate line of business.

* * * * *

§ 1.410(b)-2 [Amended]

Par. 3. Section 1.410(b)-2 is amended as follows:

1. Paragraph (b)(7) is amended by removing the reference “§ 1.410(b)-

7(c)(5)” from the second sentence and adding “§ 1.410(b)-7(c)(4)” in its place.

§ 1.410(b)-6 [Amended]

Par. 4. Section 1.410(b)-6 is amended as follows:

1. Paragraph (d)(1) is amended by removing the reference “§ 1.410(b)-7(c)(5)” from the second sentence and adding “§ 1.410(b)-7(c)(4)” in its place.
2. Paragraph (d)(2)(iv) is amended by removing the reference “§ 1.410(b)-7(c)(5)” from the fourth sentence of *Example 2(i)* and adding “§ 1.410(b)-7(c)(4)” in its place.

§ 1.410(b)-7 [Amended]

Par. 5. Section 1.410(b)-7 is amended as follows:

1. Paragraphs (c)(4) and (c)(5) are revised.
2. Paragraph (c)(6) is removed.
3. Paragraph (d)(4) is amended by removing the reference “(c)(5)” from the second and third sentences and adding “(c)(4)” in its place.
4. The revised provisions read as follows:

§ 1.410(b)-7 Definition of plan and rules governing plan disaggregation and aggregation.

* * * * *

(c) * * *

(4) *Plans benefiting certain disaggregation populations of employees—(i) In general—(A) Single plan must be treated as separate plans.* If a plan (i.e., a single plan within the meaning of section 414(l)) benefits employees of more than one disaggregation population, the plan must be disaggregated and treated as separate plans, each separate plan consisting of the portion of the plan benefiting the employees of each disaggregation population. See paragraph (c)(4)(ii) of this section for the definition of disaggregation population.

(B) *Benefit accruals or allocations attributable to current status.* Except as otherwise provided in paragraph (c)(4)(i)(C) of this section, in applying the rule of paragraph (c)(4)(i)(A) of this section, the portion of the plan benefiting employees of a disaggregation population consists of all benefits accrued by, or all allocations made to, employees while they were members of the disaggregation population.

(C) *Exceptions for certain benefit accruals—(1) Attribution of benefits to first disaggregation population.* If employees benefiting under a plan change from one disaggregation population to a second disaggregation population, benefits they accrue while members of the second disaggregation population that are attributable to years

of service previously credited while the employees were members of the first disaggregation population may be treated as provided to them in their status as members of the first disaggregation population and thus included in the portion of the plan benefiting employees of the first disaggregation population. This special treatment is available only if it is applied on a consistent basis, if it does not result in significant discrimination in favor of highly compensated employees, and if the plan provision providing the additional benefits applies on the same terms to all similarly-situated employees. For example, if all formerly collectively bargained employees accrue additional benefits under a plan after becoming noncollectively bargained employees, then those benefit increases may be treated as included in the portion of the plan benefiting collectively bargained employees if they are attributable to years of service credited while the employees were collectively bargained (e.g., where the additional benefits result from compensation increases that occur while the employees are noncollectively bargained or from plan amendments affecting benefits earned while collectively bargained that are adopted while the employees are noncollectively bargained) and if such treatment does not result in significant discrimination in favor of highly compensated employees.

(2) *Attribution of benefits to current disaggregation population.* If employees benefiting under a plan change from one disaggregation population to another disaggregation population, benefits they accrue while members of the first disaggregation population may be treated as provided to them in their current status and thus included in the portion of the plan benefiting employees of the disaggregation population of which they are currently members. This special treatment is available only if it is applied on a consistent basis and if it does not result in significant discrimination in favor of highly compensated employees.

(D) *Change in disaggregation populations—(1) Reasonable treatment.* If, in previous years, the configuration of a plan's disaggregation populations differed from their configuration for the current year, for purposes of the benefits accrued by, or allocations made to, an employee for those years, the employee's status as a member of a current disaggregation population for those years must be determined on a reasonable basis. A different configuration occurs, for example, if disaggregation populations exist for the

first time, such as when an employer is first treated as operating qualified separate lines of business, or if the existing disaggregation populations change, such as when an employer redesignates its qualified separate lines of business.

(2) *Example.* The following example illustrates the application of this paragraph (c)(4)(i)(D).

Example. (a) Employer X operates Divisions M and N, which are treated as qualified separate lines of business for the first time in 1998. Thus, the disaggregation populations of employees of Division M and employees of Division N exist for the first time. Since 1981 Employer X has maintained a defined benefit plan, Plan P, for employees of Division M. Plan P provides a normal retirement benefit of one percent of average annual compensation for each year of service up to 25. Employee A has worked for Division M since 1981 and has never worked for Division N. Employee B has worked for Division N since 1989 and worked for Division M from 1981 to 1988. Employee C has worked in the headquarters of Employer X since 1981. For the period 1981 to 1988 Employee C was credited with years of service under Plan P.

(b) For purposes of the benefits accrued by Employee A under Plan P during years 1981 through 1997, Employee A is reasonably treated as having been a member of the Division M disaggregation population for those years. For purposes of the benefits accrued by Employee B under Plan P during years 1981 through 1988, Employee B is reasonably treated as having been a member of the Division M disaggregation population for 1981 through 1988 and as having changed to the Division N disaggregation population for 1989 through 1997. For purposes of the benefits accrued by Employee C under Plan P during years 1981 through 1988, Employee C is reasonably treated as having been a member of the Division M disaggregation population for those years. Moreover, any benefit accruals for Employee B and Employee C in years after 1988, that result from increases in average annual compensation after 1988 and that are attributable to years of service credited for 1981 through 1988, may be treated as provided to Employee B and Employee C in their status as members of the Division M disaggregation population if the requirements of paragraph (c)(4)(i)(C)(1) of this section are otherwise met.

(ii) *Definition of disaggregation population—(A) Plan benefiting employees of qualified separate lines of business.* If an employer is treated as operating qualified separate lines of business for purposes of section 410(b) in accordance with § 1.414(r)-1(b), and a plan benefits employees of more than one qualified separate line of business, the employees of each qualified separate line of business are separate disaggregation populations. In this case, the portion of the plan benefiting the employees of each qualified separate

line of business is treated as a separate plan maintained by that qualified separate line of business. However, employees of different qualified separate lines of business who are benefiting under a plan that is tested under the special rule for employer-wide plans in § 1.414(r)-1(c)(2)(ii) for a plan year are not separate disaggregation populations merely because they are employees of different qualified separate lines of business.

(B) *Plan benefiting collectively bargained employees.* If a plan benefits both collectively bargained employees and noncollectively bargained employees, the collectively bargained employees are one disaggregation population and the noncollectively bargained employees are another disaggregation population. If the population of collectively bargained employees includes employees covered under different collective bargaining agreements, the population of employees covered under each collective bargaining agreement is also a separate disaggregation population.

(C) *Plan maintained by more than one employer.* If a plan benefits employees of more than one employer, the employees of each employer are separate disaggregation populations. In this case, the portion of the plan benefiting the employees of each employer is treated as a separate plan maintained by that employer, which must satisfy section 410(b) by reference only to that employer's employees. However, for purposes of this paragraph (c)(4)(ii)(C), if the plan of one employer (or, in the case of a plan maintained by more than one employer, the plan provisions applicable to the employees of one employer) treats compensation or service with another employer as compensation or service with the first employer, then the current accruals attributable to that compensation or service are treated as provided to an employee of the first employer under the plan of the first employer (or the portion of a plan maintained by more than one employer benefiting employees of the first employer), and the provisions of paragraph (c)(4)(i)(C) of this section do not apply to those accruals. Thus, for example, if Plan A maintained by Employer X imputes service or compensation for an employee of Employer Y, then Plan A is not treated as benefiting the employees of more than one employer merely because of this imputation.

(5) *Additional rule for plans benefiting employees of more than one qualified separate line of business.* If a plan benefiting employees of more than one qualified separate line of business

satisfies the reasonable classification requirement of § 1.410(b)-4(b) before the application of paragraph (c)(4) of this section, then any portion of the plan that is treated as a separate plan as a result of the application of paragraphs (c)(4)(i)(A) and (ii)(A) of this section is deemed to satisfy that requirement.

Par. 6. Section 1.414(q)-1 is added to read as follows:

§ 1.414(q)-1 Highly compensated employee.

Q&A-1 through Q&A-8: [Reserved] See § 1.414(q)-1T, Q&A-1 through Q&A-8 for further guidance.

Q-9: How is the top-paid group determined?

A-9: (a) [Reserved] See § 1.414(q)-1T, Q&A-9(a) for further guidance.

(b) *Number of employees in the top-paid group—(1) Exclusions.* The number of employees who are in the top-paid group for a year is equal to 20 percent of the total number of active employees of the employer for such year. However, solely for purposes of determining the total number of active employees in the top-paid group for a year, the employees described in § 1.414(q)-1T, A-9(b)(1) (i), (ii) and (iii)(B) are disregarded.

Paragraph (g) of this A-9 provides rules for determining those employees who are excluded for purposes of applying section 414(r)(2)(A), relating to the 50-employee requirement applicable to a qualified separate line of business.

(i) through (iii) [Reserved] See § 1.414(q)-1T, Q&A-9(b)(1) (i) through (iii) for further guidance.

(2) *Alternative exclusion provisions—(i) and (ii)* [Reserved] See § 1.414(q)-1T, Q&A-9(b)(2) (i) and (ii) for further guidance.

(iii) *Method of election.* The elections in this paragraph (b)(2) must be provided for in all plans of the employer and must be uniform and consistent with respect to all situations in which the section 414(q) definition is applicable to the employer. Thus, with respect to all plan years beginning in the same calendar year, the employer must apply the test uniformly for purposes of determining its top-paid group with respect to all its qualified plans and employee benefit plans. If either election is changed during the determination year, no recalculation of the look-back year based on the new election is required, provided the change in election does not result in discrimination in operation.

(c) through (f) [Reserved] See § 1.414(q)-1T, Q&A-9 (c) through (f) for further guidance.

(g) *Excluded employees under section 414(r)(2)(A)—(1) In general.* This

paragraph (g) provides the rules for determining which employees are excluded employees for purposes of applying section 414(r)(2)(A), relating to the 50-employee requirement applicable to a qualified separate line of business.

(2) *Excluded employees*—(i) *Age and service exclusion*. All employees are excluded who are described in § 1.414(q)-1T, A-9(b)(1)(i) (relating to exclusions based on age or service). For this purpose, the rules in § 1.414(q)-1T, A-9 (e) and (f) (relating respectively to the 17½-hour rule and the 6-month rule) apply. However, the election in § 1.414(q)-1T, A-9(b)(2)(i) (permitting the employer to elect reduced minimum age or service requirements) does not apply.

(ii) *Nonresident alien exclusion*. All employees are excluded who are described in § 1.414(q)-1T, A-9(b)(1)(ii) (relating to the exclusion of nonresident aliens with no U.S.-source income from the employer).

(iii) *Inclusion of employees covered under a collective bargaining agreement*. All employees are included who are described in § 1.414(q)-1T, A-9(b)(1)(iii)(A) (relating to employees covered under a collective bargaining agreement) and who are not otherwise described in paragraph (g)(2) (i) or (ii) of this A-9. For this purpose, the exclusion in § 1.414(q)-1T, A-9(b)(1)(iii)(B) and the related election in § 1.414(q)-1T, A-9(b)(2)(ii) do not apply.

(3) *Applicable period*. The determination of which employees are excluded employees is made on the basis of the testing year specified in the regulations under section 414(r) and not on the basis of the determination year or the look-back year under section 414(q).

(h) *Effective date*. The provisions of this A-9 apply to plan years and testing years beginning on or after January 1, 1994.

Q&A-10 through Q&A-15: [Reserved]
See § 1.414(q)-1T, Q&A-10 through Q&A-15 for further guidance.

§ 1.414(g)-1T [Amended]

Par. 7. Section 1.414(q)-1T, paragraph A-9, is amended as follows:

1. The introductory text of paragraph (b)(1) is revised.
2. Paragraph (b)(2)(iii) is revised.
3. Paragraph (g) is removed.
4. The revised provisions read as follows:

§ 1.414(q)-1T Highly compensated employee (Temporary).

* * * * *

A-9:

* * * * *

(b) *Number of employees in the top-paid group*—(1) *Exclusions*. [Reserved]

See § 1.414(q)-1, Q&A-9(b)(1) for further information.

* * * * *

(2) * * *

(iii) *Method of election*. [Reserved]
See § 1.414(q)-1, Q&A-9(b)(2)(iii) for further information.

* * * * *

§ 1.414(r)-0 [Amended]

Par. 8. Section 1.414(r)-0, paragraph (b), is amended as follows:

1. Entries for § 1.414(r)-2, paragraphs (b)(2) (i) and (ii), are added.
2. The entries for § 1.414(r)-3 are amended by:
 - a. Removing the entries for paragraphs (c)(4)(i) and (c)(4)(ii);
 - b. Revising the entry for paragraph (c)(5)(iii) and adding entries for paragraphs (c)(5)(iii) (A) and (B).
3. The entries for § 1.414(r)-6 are amended by:
 - a. Revising the entry for paragraph (b).
 - b. Removing the entries for paragraphs (c) and (c)(1) through (c)(12).
4. The entries for § 1.414(r)-7 are amended by:
 - a. Removing the entry for paragraph (c)(2);
 - b. Redesignating the entries for paragraphs (c)(3) through (c)(5) as paragraphs (c)(2) through (c)(4);
 - c. Adding new entries for paragraphs (c)(5) and (c)(5)(i) through (c)(5)(iv);
 - d. Removing the entries for paragraphs (d) and (d)(1) through (d)(3).
5. The entries for § 1.414(r)-8 are amended by:
 - a. Revising the entry for paragraph (b)(2)(iii) and adding entries for paragraphs (b)(2)(iii) (A) and (B).
 - b. Removing the entry for paragraph (d)(4).
 - c. Redesignating the entry for paragraph (d)(5) as paragraph (d)(4).
6. The added and revised entries read as follows:

- a. Removing the entry for paragraph (c)(2);
- b. Redesignating the entries for paragraphs (c)(3) through (c)(5) as paragraphs (c)(2) through (c)(4);
- c. Adding new entries for paragraphs (c)(5) and (c)(5)(i) through (c)(5)(iv);
- d. Removing the entries for paragraphs (d) and (d)(1) through (d)(3).
5. The entries for § 1.414(r)-8 are amended by:
 - a. Revising the entry for paragraph (b)(2)(iii) and adding entries for paragraphs (b)(2)(iii) (A) and (B).
 - b. Removing the entry for paragraph (d)(4).
 - c. Redesignating the entry for paragraph (d)(5) as paragraph (d)(4).
6. The added and revised entries read as follows:

§ 1.414(r)-0 Table of Contents.

* * * * *

(b) * * *

* * * * *

§ 1.414(r)-2 Line of business.

* * * * *

(b) * * *

(2) * * *

(i) In general.

(ii) Timing of provision of property or services.

* * * * *

§ 1.414(r)-3 Separate line of business.

* * * * *

(c) * * *

(5) * * *

(iii) Optional rule for employees who change status.

(A) In general.

(B) Change in employee's status.

* * * * *

§ 1.414(r)-6 Qualified separate line of business—administrative scrutiny requirement—individual determinations.

* * * * *

(b) Authority to establish procedures.

§ 1.414(r)-7 Determination of the employees of an employer's qualified separate lines of business.

* * * * *

(c) * * *

(5) Small group method.

(i) In general.

(ii) Size of group.

(iii) Composition of qualified separate line of business.

(iv) Reasonable allocation.

§ 1.414(r)-8 Separate application of section 410(b)

* * * * *

(b) * * *

(2) * * *

(iii) Modification of unsafe harbor percentage for plans satisfying ratio percentage test at 90 percent level.

(A) General Rule.

(B) Facts and circumstances alternative.

* * * * *

§ 1.414(r)-1 [Amended]

Par. 9. Section 1.414(r)-1 is amended as follows:

1. The fourth and seventh sentences of the *Example* in paragraph (c)(2)(ii) are amended by adding the language "nonhighly compensated" immediately after "nonexcludable."
2. Paragraph (c)(3)(ii) is revised.
3. The last sentence of paragraph (d)(4) is amended by adding the language "scrutiny" immediately after "administrative."
4. Paragraph (d)(9)(i) is amended by removing the reference "1992" from the end of the sentence and adding the language "1994 (or January 1, 1996, in the case of plans maintained by organizations exempt from income taxation under section 501(a), including plans subject to section 403(b)(12)(A)(i) (nonelective plans))" in its place.
5. The last sentence of paragraph (e) is amended by removing the language "and new conditions under which an individual determination may be requested under section § 1.414(r)-6".
6. The revised provision reads as follows:

§ 1.414(r)-1 Requirements applicable to qualified separate lines of business.

* * * * *

(c) * * *

(3) * * *

(ii) *Special rule for employer-wide plans*. Notwithstanding the first sentence of paragraph (c)(3)(i) of this section, an employer that is treated as

operating qualified separate lines of business in accordance with paragraph (b) of this section for purposes of both sections 410(b) and 401(a)(26) may apply the requirements of section 401(a)(26) on an employer-wide rather than a qualified-separate-line-of-business basis with respect to any plan (within the meaning of § 1.414(r)-9(c)(2), but without regard to the mandatory disaggregation rule of § 1.401(a)(26)-2(d)(1)(iv) for portions of a plan that benefit employees of different qualified separate lines of business), but only if the special rule for employer-wide plans in paragraph (c)(2)(ii) of this section is applied to the same plan for the same plan year.

§ 1.414(r)-2 [Amended]

Par. 10. Section 1.414(r)-2 is amended as follows:

1. Paragraph (b)(2) is revised.
2. *Example 1* and *Example 2* in paragraph (c)(3) are revised.
3. The revised provisions read as follows:

§ 1.414(r)-2 Line of business.

(b) * * *

(2) *Property and services provided to customers*—(i) *In general.* Property, whether real or personal, tangible or intangible, is provided by an employer to a customer if the employer provides the property to or on behalf of the customer for consideration. Similarly, services are provided by an employer to a customer if the employer renders the services to or on behalf of the customer for consideration. An individual item of property or service is taken into account under this paragraph (b)(2) only if the employer provides the item to a person other than the employer in the ordinary course of a trade or business conducted by the employer and the person to whom the employer provides the item is acting in the capacity of a customer of the employer. A type of tangible property is deemed to be provided to customers of the employer for purposes of this section if, with respect to a business that produces or manufactures that type of tangible property, the employer satisfies the special rule in § 1.414(r)-3(d)(2)(iii)(B) for vertically integrated businesses.

(ii) *Timing of provision of property or services.* Generally an employer determines its lines of business on the basis of the property and services it provides to its customers for consideration during the testing year. However, it is not necessary both that property or services actually be provided, and that consideration for the

property or services actually be paid, during the current testing year. For an employer to be considered to provide property or services to customers for consideration during a testing year under this paragraph (b)(2), it is sufficient that the property or services actually be provided to customers during the testing year, the consideration actually be paid during the testing year, or the employer actually incur significant costs during the testing year associated with the provision of the property or services to a specified customer or specified customers.

* * * * *

(c) * * *
(3) * * *

Example 1. Employer H operates several dairy farms and dairy product processing plants. The dairy farms provide part of their output of milk and milk by-products to Employer H's dairy product processing plants and also sell part to retail distributors unrelated to Employer H. The dairy farms' provision of milk and milk by-products to Employer H's dairy product processing plants does not constitute the provision of property or services to customers of Employer H because the milk and milk by-products are not provided to a person other than employer H. However, the dairy farms' provision of milk and milk by-products to independent retail distributors does constitute the provision of property or services to customers of Employer H under paragraph (b)(2) of this section.

Example 2. The facts are the same as in *Example 1*, except that the dairy farms provide their entire output of milk and milk by-products to Employer H's dairy product processing plants. The dairy farms' provision of milk and milk by-products to the dairy product processing plants generally does not constitute the provision of property or services to customers of Employer H because the milk and milk by-products are not provided to a person other than Employer H. However, paragraph (b)(2)(i) of this section provides a special rule for vertically integrated businesses that satisfy § 1.414(r)-3(d)(2)(iii)(B). If § 1.414(r)-3(d)(2)(iii)(B) is satisfied, then, under the special rule of paragraph (b)(2)(i) of this section, the milk and milk by-products are deemed to be provided to customers of Employer H.

* * * * *

§ 1.414(r)-3 [Amended]

Par. 11. Section 1.414(r)-3 is amended as follows:

1. The second sentence of paragraph (b)(4) is revised.
2. Paragraph (c)(2)(ii) is revised.
3. Paragraph (c)(4) is revised.
4. Paragraph (c)(5)(iii) is revised.
5. The last sentence of the introductory text of paragraph (c)(6) is revised.
6. A sentence is added to the end of *Example 2* of paragraph (c)(6).

7. In paragraph (c)(6), the phrase "(in accordance with paragraph (c)(5)(iii) of this section)" is removed from the seventh sentence of *Example 3*, the fifth sentence of *Example 4*, the fifth and sixth sentences of *Example 5*, and the fifth sentence of *Example 7*.

8. Two sentences are added to the end of *Example 5* of paragraph (c)(6).

9. A sentence is added to the end of the introductory text of paragraph (c)(7).

10. *Example 1* of paragraph (c)(7) is revised.

11. In *Example 2* of paragraph (c)(7), the phrase "(in accordance with paragraph (c)(5)(iii) of this section)" is removed from the third sentence.

12. *Examples 3* and *4* of paragraph (c)(7) are redesignated *Examples 4* and *5*, respectively, and a new *Example 3* is added.

13. The first sentence of newly designated *Example 5* in paragraph (c)(7) is amended by removing the reference "*Example 3*" and adding "*Example 4*" in its place.

14. Paragraph (d)(2) is revised.

15. *Example 1* of paragraph (d)(4) is revised.

16. The additions and revisions read as follows:

§ 1.414(r)-3 Separate line of business.

* * * * *

(b) * * *

(4) *Separate employee workforce.*

* * * A line of business has its own separate workforce only if at least 90 percent of the employees who provide services to the line of business, and who are not substantial-service employees with respect to any other line of business, are substantial-service employees with respect to the line of business. * * *

(c) * * *

(2) * * *

(ii) The denominator of which is the total number of employees who provide services to the line of business within the meaning of paragraph (c)(5) of this section and who are not substantial-service employees with respect to any other line of business.

* * * * *

(4) *Employees taken into account.* For purposes of applying this paragraph (c), only employees who are employees on the first testing day are taken into account. For this purpose, there are no excludable employees except nonresident aliens described in section 410(b)(3)(C). Consequently, all other employees who are employees on the first testing day are taken into account, including collectively bargained employees. For the definition of first testing day, see § 1.414(r)-11(b)(7).

(5) * * *

(iii) *Optional rule for employees who change status*—(A) *In general.* Solely for purposes of the separateness rules of this section and the assignment rules of § 1.414(r)-7, if an employee changes status as described in paragraph (c)(5)(iii)(B) of this section, an employer may, for up to three consecutive testing years after the base year (within the meaning of paragraph (c)(5)(iii)(B) (1) or (2) of this section), treat the employee as providing the same level of service to its lines of business as the employee provided in the base year.

(B) *Change in employee's status.* An employee changes status as described in this paragraph (c)(5)(iii)(B) if—

(1) For a testing year (the base year), the employee was a substantial-service employee with respect to a qualified separate line of business of the employer (prior line of business) and, for the immediately succeeding testing year, the employee is not a substantial-service employee with respect to that prior line of business; or

(2) For a testing year (the base year), the employee was a residual shared employee and, for the immediately succeeding testing year, the employee is a substantial-service employee with respect to a qualified separate line of business.

(c) * * *

(6) * * * Unless otherwise specified, it is assumed that the employees and their services described in these examples are taken into account under paragraphs (c) (4) and (5) of this section for the testing year and that the employer does not use the option under § 1.414(r)-11(b)(2) to treat employees who provide less than 75 percent of their services to a line of business as substantial-service employees with respect to the line of business.

* * * * *

Example 2. * * * Moreover, because Employees M and N provide at least 75 percent of their services to Employer A's tire and automotive products line of business and are substantial-service employees with respect to that line, they are disregarded in applying paragraph (b)(4) of this section to any other line of business, even if they provide services to the other line.

* * * * *

Example 5. * * * Under the definition of substantial-service employee in § 1.414(r)-11(b)(2), Employer A may treat Employee R as a substantial-service employee with respect to the tire and automotive products line of business because Employee R provides at least 50 percent of his services to that line. In that case, Employee R would be disregarded in applying paragraph (b)(4) of this section to the construction machinery and agricultural equipment lines of business.

* * * * *

(7) * * * Unless otherwise specified, it is assumed that employees who provide services to a line of business are not substantial-service employees with respect to any other line of business and that, in determining the top-paid employees with respect to a line of business, the employer is using the option under § 1.414(r)-11(b)(3) to disregard all employees who provide less than 25 percent of their services to that line of business.

Example 1. (a) Employer C operates three lines of business as determined under § 1.414(r)-2. One of its lines of business is the operation of a chain of athletic equipment and apparel stores. Of Employer C's total workforce, 12,000 employees provide more than a negligible amount of the services they provide to Employer C to the athletic equipment and apparel stores line of business, within the meaning of paragraph (c)(5) of this section. Of the 1,200 employees who constitute the top ten percent by compensation of those 12,000 employees, 930 are substantial-service employees with respect to that line of business. Because 930 is 77.5 percent of 1,200, less than 80 percent of the top-paid employees with respect to the line of business are substantial-service employees with respect to that line of business. Therefore, Employer C's athletic equipment and apparel stores line of business does not have its own separate management under paragraph (b)(5) of this section.

(b) Assume that, in determining the top-paid employees with respect to the athletic equipment and apparel stores line of business, Employer C chooses to disregard all employees who provide less than 25 percent of their services to the line of business as permitted under the definition in § 1.414(r)-11(b)(3). Of the 12,000 employees who provide more than a negligible amount of their services to the athletic equipment and apparel stores line of business, 10,000 provide at least 25 percent of their services to that line. Of the 1,000 employees who constitute the top ten percent by compensation of those 10,000 employees, 930 are substantial-service employees with respect to the athletic equipment and apparel stores line of business. Because 930 is 93 percent of 1,000, at least 80 percent of the top-paid employees with respect to the line of business are substantial-service employees with respect to that line of business. Therefore, Employer C's athletic equipment and apparel stores line of business has its own separate management and satisfies the requirement of paragraph (b)(5) of this section.

* * * * *

Example 3. The facts are the same as in *Example 2* except that Employee X provides 60 percent of his services to Employer C's second line of business, an athletic equipment factory, and 30 percent of his service to Employer C's third line of business, a fast-food chain. Because Employee X provides at least 50 percent of his services to the athletic equipment factory line of business, Employer C chooses to treat

him as a substantial-service employee with respect to that line of business, as permitted under § 1.414(r)-11(b)(2). Thus, Employee X is taken into account as a substantial-service employee with respect to the athletic equipment factory line of business and is disregarded in applying the separate workforce and separate management requirements under paragraphs (b) (4) and (5) to the fast-food chain line of business.

* * * * *

(d) * * *

(2) *Requirements.* Two lines of business satisfy the requirements of this paragraph (d) with respect to a type of property or service only if—

(i) One of the lines of business (the upstream line of business) provides a type of property or service to the other line of business (the downstream line of business);

(ii) The downstream line of business either—

(A) Uses, consumes, or substantially modifies the property or service in the course of itself providing property or services to customers of the employer; or

(B) Provides the same property or service to customers of the employer at a different level in the chain of commercial distribution from the upstream line of business (e.g., retail versus wholesale); and

(iii) The upstream line of business either—

(A) Provides the same type of property or service to customers of the employer, and at least 25 percent of the total number of units of the same type of property or service provided by the upstream line of business to all persons (including customers of the employer, the downstream line of business, and all other lines of business of the employer) are provided to customers of the employer by the upstream line of business, when measured on a uniform basis; or

(B) Provides to the downstream line of business property consisting primarily of a type of tangible property (i.e., goods, not services) that it produces or manufactures, and some entities outside the employer's controlled group that are engaged in a similar business as the upstream line of business provide the same type of tangible property to unrelated customers (i.e., customers outside those entities' respective controlled groups).

* * * * *

(4) * * *

Example 1. Employer E operates two lines of business as determined under § 1.414(r)-2, one engaged in upholstery textile manufacturing and the other in furniture manufacturing. During the testing year, the upholstery textile line of business provides

its entire output of upholstery textiles to the furniture line of business. The furniture line of business uses the upholstery textiles in the manufacture of upholstered furniture for sale to customers of Employer E. The furniture line of business thus substantially modifies the upholstery textiles provided to it by the upholstery textile line of business in providing upholstered furniture products to customers of Employer E. In addition, although the upholstery textile line of business does not provide upholstery textiles to customers of Employer E, some entities engaged in upholstery textile manufacturing provide upholstery textiles to customers outside their controlled groups. Under these facts, Employer E's two lines of business satisfy the requirements of this paragraph (d) with respect to upholstery textiles for the testing year.

§ 1.414(r)-4 [Amended]

Par. 12. Section 1.414(r)-4 is amended by removing the reference "§ 1.414(q)-1T" from the last sentence of paragraph (b) and adding "§ 1.414(q)-1" in its place.

§ 1.414(r)-5 [Amended]

Par. 13. Section 1.414(r)-5 is amended as follows:

1. Paragraph (b)(5)(ii) is revised.
2. Paragraphs (d)(1)(ii) (B) and (C) are revised.
3. The concluding text of paragraph (d)(1) is removed.
4. Paragraph (d)(1)(iii) is added.
5. *Example 2* of paragraph (d)(4) is revised.
6. The last sentence of paragraph (g)(2)(iii)(A) is revised.
7. Paragraph (g)(2)(iii)(D) is amended by:

- a. Revising the third sentence;
- b. Adding a sentence to the end.
8. Paragraph (g)(3)(ii)(B) is amended by adding the language "described" immediately after "amount" and removing the language "described" from after "employee."

9. The last sentence of paragraph (g)(3)(iii)(B) is amended by:
 - a. Adding the word "qualified" immediately before "disability";
 - b. Removing the reference "§ 1.401(a)(4)-3(d)(6)(vi)" and adding "section 411(a)(9)" in its place.

10. A sentence is added to the end of paragraph (g)(3)(iii)(C).
11. The last sentence of paragraph (g)(3)(iii)(D) is revised.
12. Paragraph (g)(5) is revised.
13. A sentence is added after the third sentence of paragraph (g)(6).
14. The revised provisions read as follows:

§ 1.414(r)-5 Qualified separate line of business—administrative scrutiny requirement—safe harbors.

- (b) * * *
- (5) * * *
- (ii) No more than five percent of the employees of the separate line of business for the current testing year were employees of a different separate line of business for the immediately preceding testing year, and no more than five percent of the employees of the separate line of business for the immediately preceding testing year are employees of a different separate line of business for the current testing year.

- (d) * * *
- (1) * * *
- (ii) * * *
- (B) No more than 10 percent of the employees who are substantial-service employees with respect to the acquired line of business were substantial-service employees with respect to a different separate line of business for the immediately preceding testing year; and
- (C) No more than 10 percent of the employees who were substantial-service employees with respect to the acquired line of business for the immediately preceding testing year are substantial-service employees with respect to a different separate line of business in the respective testing year.

(iii) If the transaction described in paragraph (d)(1) of this section occurs after the first testing day in a testing year, the determinations required by paragraphs (d)(1)(ii) (B) and (C) of this section with respect to that testing year are made as of the date of the transaction.

Example 2. The facts are the same as in *Example 1* except that, by the first testing day in 1997 (Transition Year 1), there are 300 additional substantial-service employees with respect to the pharmaceutical supplies line of business, increasing the total number to 4,300. Of those 300 employees, 250 were substantial-service employees with respect to a different separate line of business for testing year 1996 and 50 are new hires. Assume that, on the first testing day in Transition Year 1, the pharmaceutical supplies line of business satisfies the requirements of § 1.414(r)-3 (taking into account § 1.414(r)-1(d)(4)) and therefore constitutes a separate line of business. Because 250 is 6 percent of 4,300, no more than ten percent of the employees who are substantial-service employees with respect to the pharmaceutical supplies line of business were substantial-service employees with respect to a different separate line of business for the immediately preceding testing year. The 50 newly hired employees are disregarded in making this determination. Under these facts, the pharmaceutical supplies separate line of business satisfies the safe harbor in this paragraph (d) for Transition Year 1.

- (g) * * *
- (2) * * *
- (iii) * * *
- (A) * * * For purposes of this paragraph (g)(2)(iii), the normal accrual rate is the percentage (not less than 0) determined by subtracting the employee's normalized accrued benefit as of the end of the prior plan year (expressed as a percentage of average annual compensation as of the end of the prior plan year) from the employee's normalized accrued benefit as of the end of the plan year (expressed as a percentage of average annual compensation as of the end of the plan year).

(D) * * * However, a plan may disregard in a reasonable and consistent manner: years before the effective date of these regulations as set forth in § 1.414(r)-1(d)(9)(i), years more than 10 years preceding the current plan year, and years for which the employer does not use this paragraph (g)(2) to satisfy this safe harbor with respect to the separate line of business. * * * If a plan provides a defined benefit minimum that uses more than five consecutive years for calculating average annual compensation or the plan is an accumulation plan as defined in § 1.401(a)(4)-12, the 0.75 percent annual accrual rate in paragraph (g)(2)(iii)(A) of this section is multiplied by 133.3 percent, resulting in a normal accrual rate equal to 1.0 percent.

- (3) * * *
- (iii) * * *
- (C) * * * In addition, no adjustment is made to the maximum normal accrual rate because the plan uses more than five consecutive years for calculating average annual compensation or the plan is an accumulation plan as defined in § 1.401(a)(4)-12.

(D) * * * In the case of a plan with subsidized optional forms, the determination of accrual rate for the plan year under paragraph (g)(2)(iii)(A) of this section is the percentage (not less than 0) determined by subtracting the largest of the sums of the employee's normalized QJSAs and QSUPPs determined for each age under § 1.401(a)(4)-3(d)(1)(ii) as of the end of the prior plan year (expressed as a percentage of average annual compensation as of the end of the prior plan year) from the largest of the sums of the employee's normalized QJSAs and QSUPPs determined for each age under § 1.401(a)(4)-3(d)(1)(ii) as of the end of the plan year (expressed as a percentage of average annual

compensation as of the end of the plan year).

(5) *Certain contingency provisions ignored.* For purposes of this paragraph (g), an employee's accrual or allocation rate is determined without regard to any minimum benefit or any maximum benefit limitation that is applicable to the employee only if the separate line of business fails otherwise to satisfy the requirement of administrative scrutiny.

(6) * * * For purposes of the minimum benefit requirement of paragraph (g)(2) of this section, section 410(b)(4) may be applied with reference to the lowest minimum age requirement, and with reference to the lowest minimum service requirement, applicable under any plan of the employer that benefits highly compensated employees of the separate line of business, as if all the plans were a single plan under § 1.410(b)-6(b)(2), or, if no plan of the employer benefits highly compensated employees of the separate line of business, with reference to the greatest age and service requirements permitted under section 410(a)(1)(A). * * *

§ 1.414(r)-8 [Amended]

Par. 14. Section 1.414(r)-6 is amended as follows:

1. Paragraph (a) is amended by:
 - a. Revising the third sentence.
 - b. Adding a new sentence immediately following the second sentence.
 - c. Removing the last sentence.
2. Paragraph (b) is revised.
3. Paragraph (c) is removed.
4. The addition and revisions read as follows:

§ 1.414(r)-6 Qualified separate line of business—administrative scrutiny requirement—individual determinations

(a) * * * The Commissioner shall issue such an individual determination only when it is consistent with the purpose of section 414(r), taking into account the nondiscrimination requirements of sections 401(a)(4) and 410(b). Paragraph (b) of this section authorizes the Commissioner to establish procedures for requesting and granting individual determinations.

(b) *Authority to establish procedures.* The Commissioner may, in revenue rulings and procedures, notices, and other guidance, published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter), provide any additional guidance that may be necessary or appropriate for requesting and granting individual determinations under this section. For example, such guidance may specify the

circumstances in which an employer may request an individual determination and factors to be taken into account in deciding whether to grant a favorable individual determination. In addition, such guidance may describe situations that automatically fail the administrative scrutiny requirement.

§ 1.414(r)-7 [Amended]

Par. 15. Section 1.414(r)-7 is amended as follows:

1. The last sentence of paragraph (a)(1) is revised.
2. Paragraph (b)(2)(ii) is amended by removing the language "with respect to a qualified separate line of business".
3. The last sentence of paragraph (b)(3) is amended by removing the language "(including whether the residual shared employee is eligible for assignment under paragraph (c)(2) of this section)".
4. Paragraph (c)(1) is revised.
5. Paragraph (c)(2) is removed.
6. Paragraphs (c)(3) through (c)(5) are redesignated (c)(2) through (c)(4), respectively, and a new paragraph (c)(5) is added.
7. Redesignated paragraphs (c)(2)(i), (c)(3)(i) and (c)(4)(i) are amended by removing the language "who are not assigned under paragraph (c)(2) of this section".
8. Redesignated paragraphs (c)(2)(i), (c)(2)(v), and *Example 2*, *Example 3* and *Example 4* of paragraph (c)(2)(v) are amended by removing the reference "paragraph (c)(3)" and adding "paragraph (c)(2)" in its place.
9. Redesignated paragraph (c)(2)(ii) and paragraph (ii) of *Example 1* of redesignated paragraph (c)(2)(v) are amended by removing the reference "paragraph (c)(3)(iii)" and adding "paragraph (c)(2)(ii)" in its place.
10. Redesignated paragraph (c)(2)(i) is amended by removing the reference "paragraph (c)(3)(iv)" and adding "paragraph (c)(2)(iv)" in its place.
11. Redesignated paragraph (c)(2)(iii)(A) is revised.
12. Redesignated paragraph (c)(2)(iv) is revised.
13. *Example 1* of redesignated paragraph (c)(2)(v) is amended by removing the third sentence of paragraph (i).
14. *Example 2* of redesignated paragraph (c)(2)(v) is amended by removing the reference "35 percent" from the second sentence and adding "25 percent" in its place.
15. The first sentence of redesignated paragraph (c)(2)(v), *Example 4* (ii) is amended by:
 - a. Removing the reference "35" and adding "25" in its place;

b. Removing the reference "paragraph (c)(3)(iii)" and adding "paragraph (c)(2)(iv)" in its place.

16. The second sentence of redesignated paragraph (c)(2)(v), *Example 4* (ii) is amended by removing the reference "paragraph (c)(3)(iii)(B)" and adding "paragraph (c)(2)(iv)(B)" in its place.

17. Redesignated paragraphs (c)(3)(i), (c)(3)(ii), and the introductory language and third sentence of *Example 1* of redesignated paragraph (c)(3)(iii) are amended by removing the reference "paragraph (c)(4)" and adding "paragraph (c)(3)" in its place.

18. Redesignated paragraph (c)(3)(i) is amended by removing the reference "(c)(3)(iii)" and adding "(c)(2)(iii)" in its place.

19. Redesignated paragraphs (c)(3)(ii)(A) and (c)(3)(ii)(B) are amended by removing the reference "(c)(4)(i)" and adding "(c)(3)(i)" in its place.

20. The first sentence of *Example 1* of redesignated paragraph (c)(3)(iii) is amended by removing the reference "paragraph (c)(3)(iv)" and adding "paragraph (c)(2)(v)" in its place and by removing the word "and" and adding "except" in its place.

21. Redesignated paragraphs (c)(4)(i), (c)(4)(ii), and (c)(4)(iii) are amended by removing the reference "paragraph (c)(5)" and adding "paragraph (c)(4)" in its place.

22. Redesignated paragraph (c)(4)(iii)(E) is amended by removing the reference "(c)(5)(iii)" and adding "(c)(4)(iii)" in its place.

23. Paragraph (d) is removed.

24. The added and revised provisions read as follows:

§ 1.414(r)-7 Determination of the employees of an employer's qualified separate lines of business.

(a) * * *

(1) *In general.* * * * Paragraph (c) of this section provides methods for allocating residual shared employees among qualified separate lines of business.

* * *

(c) * * *

(1) *In general.* All residual shared employees must be allocated among an employer's qualified separate lines of business under one of the allocation methods provided in paragraphs (c)(2) through (5) of this section. An employer is permitted to select which method of allocation to apply for the testing year to residual shared employees. However, the same allocation method must be used for all of the employer's residual shared employees and for all purposes listed in paragraph (a)(2) of this section with respect to the testing year.

(2) * * *

(iii) * * * (A) *Determination of percentage.* The employee assignment percentage of a qualified separate line of business is the fraction (expressed as a percentage)—

(1) The numerator of which is the number of substantial-service employees with respect to the qualified separate line of business who are assigned to that line of business under paragraph (b) of this section; and

(2) The denominator of which is the total number of substantial-service employees who are assigned to all qualified separate lines of business of the employer under paragraph (b) of this section.

* * *

(iv) *Option to apply reduced percentage.* An employer is permitted to determine whether it has a dominant line of business by substituting 25 percent for 50 percent in paragraph (c)(2)(ii) of this section. This option is available for a testing year only if the qualified separate line of business satisfies one of the following requirements:

(A) The qualified separate line of business accounts for at least 60 percent of the employer's gross revenues for the employer's latest fiscal year ending in the testing year.

(B) The employee assignment percentage of the qualified separate line of business would be at least 60 percent if collectively bargained employees were taken into account.

(C) Each qualified separate line of business of the employer satisfies the statutory safe harbor of § 1.414(r)-5(b), the average benefits safe harbor of § 1.414(r)-5(f), or the minimum or maximum benefits safe harbor of § 1.414(r)-5(g). Whether a qualified separate line of business satisfies one of these safe harbors is determined after the application of this section, including the assignment of all residual shared employees under this paragraph (c)(2).

(D) The employee assignment percentage of the qualified separate line of business is at least twice the employee assignment percentages of each of the employer's other qualified separate lines of business.

* * *

(5) *Small group method*—(i) *In general.* Under the method of allocation provided for in this paragraph (c)(5), each residual shared employee is allocated to a qualified separate line of business chosen by the employer. This method does not apply unless all of the requirements of paragraphs (c)(5)(ii), (iii), and (iv) of this section are satisfied.

(ii) *Size of group.* The total number of the employer's residual shared

employees allocated under this paragraph (c) must not exceed three percent of all of the employer's employees. For this purpose, the employer's employees include only those employees taken into account under paragraph (c)(2)(iii)(B) of this section.

(iii) *Composition of qualified separate line of business.* The qualified separate line of business to which the residual shared employee is allocated must have an employee assignment percentage under paragraph (c)(2)(iii) of this section of at least ten percent. In addition, the qualified separate line of business to which the residual shared employee is allocated must satisfy the statutory safe harbor under § 1.414(r)-5(b) after the employee is so allocated.

(iv) *Reasonable allocation.* The allocation of residual shared employees under the small group method provided for in this paragraph (c)(5) must be reasonable. Reasonable allocations generally include allocations that are based on the level of services that the residual shared employees provide to the employer's qualified separate lines of business, the similar treatment of similarly situated residual shared employees, and other bona fide business criteria; in contrast, an allocation that is designed to maximize benefits for select employees is not considered a reasonable allocation. For example, allocation of all residual shared employees who work in the same department, or at the same location, to the same qualified separate line of business would be an indication of reasonableness. However, allocation of a group of similarly situated residual shared employees to a qualified separate line of business for which they provide minimal services might not be considered reasonable. In addition, the allocation of the professional employees of a department to one qualified separate line of business and the allocation of the support staff of the same department to a different qualified separate line of business would not be reasonable.

§ 1.414(r)-8 [Amended]

Par. 16. Section 1.414(r)-8 is amended as follows:

1. Paragraph (b)(2)(iii) is revised.

2. In *Example 1* and *Example 4* of paragraph (b)(4), the reference "1993" is removed from each place it appears and "1994" is added in its place.

3. *Example 2* in paragraph (b)(4) is revised.

4. *Example 3* and *Example 4* in paragraph (b)(4) are redesignated as *Example 5* and *Example 6* respectively,

and new *Example 3* and *Example 4* are added.

5. In the fifth sentence of redesignated *Example 5(ii)* in paragraph (b)(4), the reference "§ 1.410(b)-7(c)(4)" is removed and "§ 1.410(b)-7(c)(5)" is added in its place.

6. In the first and third sentences of redesignated *Example 6* in paragraph (b)(4), the reference "*Example 3*" is removed and "*Example 2*" is added in its place.

7. Paragraph (d)(4) is removed.

8. Paragraph (d)(5) is redesignated (d)(4).

9. The additions and revisions read as follows:

§ 1.414(r)-8 Separate application of section 410(b).

* * *

(b) * * *

(2) * * *

(iii) *Modification of unsafe harbor percentage for plans satisfying ratio percentage test at 90 percent level*—(A) *General rule.* If a plan benefits a group of employees for a plan year that would satisfy the ratio percentage test of § 1.410(b)-2(b)(2) on a qualified-separate-line-of-business basis under paragraph (b)(3) of this section if the percentage in § 1.410(b)-2(b)(2) were increased to 90 percent, the unsafe harbor percentage in § 1.410(b)-4(c)(4)(ii) for the plan is reduced by five percentage points (not five percent) for the plan year and is applied without regard to the requirement that the unsafe harbor percentage not be less than 20 percent. Thus, if the requirements of this paragraph (b)(2)(iii)(A) are satisfied, the unsafe harbor percentage in § 1.410(b)-4(c)(4)(ii) is treated as 35 percent, reduced by $\frac{3}{4}$ of a percentage point for each whole percentage point by which the nonhighly compensated employee concentration percentage exceeds 60 percent.

(B) *Facts and circumstances alternative.* If a plan satisfies the requirements of paragraph (b)(2)(iii)(A) of this section, but has a ratio percentage on an employer-wide basis that falls below the unsafe harbor percentage determined under paragraph (b)(2)(iii)(A) of this section, the plan nonetheless is deemed to satisfy section 410(b)(5)(B) on an employer-wide basis if the Commissioner determines that, on the basis of all of the relevant facts and circumstances, the plan benefits such employees as qualify under a classification of employees that does not discriminate in favor of highly compensated employees.

* * *

(4) * * *

Example 2. The facts are the same as in **Example 1.** All of the 50 highly compensated employees treated as employees of Line 2 benefit under Plan Y, and 80 of the 100 nonhighly compensated employees treated as employees of Line 2 benefit under Plan Y. Thus, Plan Y benefits 50 percent of all Employer A's highly compensated employees (50 out of 100) and only 4 percent of all Employer A's nonhighly compensated employees (80 out of 2,000). Thus, while Plan Y has a ratio percentage of 80 percent (80%/100%) on a qualified-separate-line-of-business basis, it has a ratio percentage of only 8 percent (4%+50%) on an employer-wide basis. See § 1.410(b)-9. Under § 1.410(b)-4(c)(4)(iii), the nonhighly compensated employee concentration percentage is 2,000/2,100 or 95 percent. Because 8 percent is less than 20 percent (the unsafe harbor percentage applicable to Employer A under § 1.410(b)-4(c)(4)(iii)), Plan Y does not satisfy the nondiscriminatory classification test of § 1.410(b)-4 on an employer-wide basis. Nor does Plan Y satisfy the ratio percentage test of § 1.410(b)-2(b)(2) on an employer-wide basis, since 8 percent is less than 70 percent. Under these facts, Plan Y does not satisfy section 410(b)(5)(B) on an employer-wide basis in accordance with paragraph (b)(2) of this section for the plan year of Plan Y beginning in the 1994 testing year, and therefore fails to satisfy section 410(b) for that year. This is true even though Plan Y satisfies section 410(b) on a qualified-separate-line-of-business basis in accordance with paragraph (b)(3) of this section.

Example 3. The facts are the same as in **Example 2**, except that all of the employees treated as employees of Line 2 benefit under Plan Y. Thus, Plan Y benefits 50 percent of all of Employer A's highly compensated employees (50 out of 100) and 5 percent of all of Employer A's nonhighly compensated employees (100 out of 2,000). Plan Y therefore has a ratio percentage of 100 percent (100%/100%) on a qualified-separate-line-of-business basis and a ratio percentage of 10 percent (5%+50%) on an employer-wide basis. Because Plan Y has a ratio percentage of at least 90 percent on a qualified-separate-line-of-business basis, a reduced unsafe harbor percentage applies to Plan Y under paragraph (b)(2)(iii)(A) of this section. The reduced unsafe harbor percentage applicable to Plan Y is 8.75 percent because Employer A's nonhighly compensated employee concentration percentage is 95 percent. Plan Y's employer-wide ratio percentage of 10 percent therefore exceeds the unsafe harbor percentage. Plan Y thus satisfies section 410(b)(5)(B) on an employer-wide basis in accordance with paragraph (b)(2) of this section for the plan year of Plan Y beginning in the 1994 testing year. Plan Y also satisfies section 410(b) on a qualified-separate-line-of-business basis in accordance with paragraph (b)(3) of this section.

Example 4. The facts are the same as in **Example 3**, except that Employer A's total nonexcludable nonhighly compensated employees are 2,500 (rather than 2,000), of whom 100 are treated as employees of Line 2 and of whom 90 benefit under Plan Y. Plan

Y has a ratio percentage of 90 percent (90%/100%) on a qualified-separate-line-of-business basis, and Employer A's nonhighly compensated employee concentration percentage is 2,500/2,600 or 96 percent. Thus, the reduced unsafe harbor percentage applicable to Plan Y under paragraph (b)(2)(iii)(A) of this section is 8 percent. Plan Y benefits 50 percent of all of Employer A's highly compensated employees (50 out of 100) and 3.6 percent of all of Employer A's nonhighly compensated employees (90 out of 2,500). Plan Y therefore has a ratio percentage of only 7.2 percent (3.6%+50%) on an employer-wide basis, which falls below the reduced unsafe harbor percentage of 8 percent. Nonetheless, under paragraph (b)(2)(iii)(B) of this section, Plan Y will be deemed to satisfy section 410(b)(5)(B) on an employer-wide basis if the Commissioner determines that, on the basis of all of the relevant facts and circumstances, the plan benefits such employees as qualify under a classification of employees that does not discriminate in favor of highly compensated employees.

§ 1.414(r)-11 [Amended]

Par. 17. Section 1.414(r)-11 is amended as follows:

1. Paragraph (b)(2) is revised.
2. The first sentence of paragraph (b)(3) is removed and two new sentences are added in its place.
3. Paragraph (b)(4) is revised.
4. Paragraph (c)(2)(v) is amended by removing the references "1.414(r)-7(c)(3)" and "1.414(r)-7(c)(4)" and adding "1.414(r)-7(c)(2)" and "1.414(r)-7(c)(3)" in their respective places.
5. The added and revised provisions read as follows:

§ 1.414(r)-11 Definitions and special rules.

(b) * * *

(2) **Substantial-service employee.** An employee is a substantial-service employee with respect to a line of business for a testing year if at least 75 percent of the employee's services are provided to that line of business for that testing year within the meaning of § 1.414(r)-3(c)(5). In addition, if an employee provides at least 50% and less than 75% of the employee's services to a line of business for the testing year within the meaning of § 1.414(r)-3(c)(5), the employer may treat that employee as a substantial-service employee with respect to that line of business provided the employee is so treated for all purposes of these regulations. The employer may choose such treatment separately with respect to each employee.

(3) **Top-paid employee.** Generally, an employee is a top-paid employee with respect to a line of business for a testing year if the employee is among the top 10 percent by compensation of those

employees who provide services to that line of business for that testing year within the meaning of § 1.414(r)-3(c)(5) and who are not substantial-service employees within the meaning of paragraph (b)(2) of this section with respect to any other line of business. In addition, in determining the group of top-paid employees, the employer may choose to disregard all employees who provide less than 25 percent of their services to the line of business. * * *

(4) **Residual shared employee.** An employee is a residual shared employee for a testing year if the employee is not a substantial-service employee with respect to any line of business for the testing year.

* * *
Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: June 14, 1994.
Leslie Samuels,
Assistant Secretary of the Treasury.
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DEPARTMENT OF EDUCATION

34 CFR Part 682

RIN 1840-AA96

Federal Family Education Loan Program

AGENCY: Department of Education.
ACTION: Final regulations; Correction.

SUMMARY: This document corrects an error in the final regulations published in the *Federal Register* on May 17, 1994 for the Federal Family Education Loan Program (59 FR 25744).

FOR FURTHER INFORMATION CONTACT: Patricia Beavan, Policy Section Loans Branch, Division of Policy Development, Policy, Training and Analysis Service, U.S. Department of Education, 400 Maryland Avenue SW. (Room 4310, ROB-3), Washington, D.C. 20202; Telephone (202) 708-8242. Individuals who use a telecommunications device for the deaf (TDD) may call the Federal Information Relay Service (FIRS) at 1-800-877-8339 between 8 a.m. and 8 p.m., Eastern Time, Monday through Friday.

DATES: This correction is effective June 27, 1994. For the effective date of the rule, see 59 FR 25744, May 17, 1994.

David A. Longanecker,
Assistant Secretary for Postsecondary Education.

The following correction is made in FR Doc. 94-11656, published on May 17, 1994 (59 FR 25744):